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# THESIS

AN INTERNAL REVIEW MODEL  
FOR THE NAVAL MILITARY  
PERSONNEL COMMAND

by

Timothy William LaFleur

December 1981

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An Internal Review Model for the Naval  
Military Personnel Command

by

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Lieutenant Commander, United States Navy  
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Submitted in partial fulfillment of the  
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

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December 1981



## ABSTRACT

The function of Internal Review (IR) is defined and its importance highlighted in order to portray the current emphasis on IR in the Department of the Navy (DON). The DON has done little work in IR. The key traits, characteristics and standards important to the execution of IR were developed from a literature search and a survey of activities practicing IR. These traits, characteristics and standards were utilized as the groundwork for a DON IR model. The Naval Military Personnel Command (NMPC) was chosen for application of the model because of its large budget and current lack of IR capability. Research of civilian and military personnel activities similar to NMPC provided data on IR practices applicable to NMPC. A model for IR at NMPC was developed by selecting common practices and characteristics from the survey respondents that were feasible for NMPC execution. The model is depicted as it could be utilized by NMPC. The author concludes that certain common traits are applicable to the IR of personnel activities but that tailoring to suit the needs of the individual entity is widely accepted.



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## I. INTRODUCTION

### A. GENERAL BACKGROUND

"Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analysis, appraisals, recommendations, counsel and information concerning the activities reviewed." [Ref. 1]

The importance and necessity for review has long been recognized by the United States (US) Government. Going back to 1921 and the establishment of the General Accounting Office (GAO) one can trace the gradual rise in the importance of the oversight and review functions. In the early 1970's, several actions took place that catapulted the internal audit function to the forefront of public attention.

First, there was Watergate, and then there was the open admission by Boeing and other contractors of bribery overseas. These events led to the passing of the Foreign Corrupt Practices Act, and the impetus for increased attention to the operation and performance of private entities and government agencies.

As stated above, the review function is not new; however, the interest and importance placed on review, in particular internal review, is new. The impact of inflation, the discovery of waste, fraud and abuse, and tax reforms have



focused the populace and thus the lawmakers attention on control of federal government activities to ensure they are performing efficiently and economically in the execution of authorized programs.

Secretary of the Navy Instruction (SECNAVINST) 7510.8, "Internal Review in the Department of the Navy," dated 15 October 1976 and Navy Comptroller Manual Volume One both provide the basis for the Navy's internal review (IR) function, but in the author's opinion give little assistance in developing the specific guidelines or standard operating procedures to meet the audit requirements. Even though the requirement for IR is well established in written directives, the current literature indicates that many commands have yet to recognize its value and comply. [Ref. 2]

## B. PROBLEM

In the Winter 1980 issue of the Financial Management Newsletter, the Comptroller of the Navy listed three areas of particular concern and significance to the financial management community. One of these areas, IR, was also the recommended solution to the other two problem areas. Rear Admiral S. D. Frost, SC, USN felt that establishment of an effective IR program is the key to eliminating waste, fraud and abuse in government expenditures [Ref. 3]. As Admiral Frost stated, "unfortunately many activities have either not implemented an IR program or have limited the scope of their efforts."



Of 142 commands reviewed by the Naval Audit Service (NAS) during 1979 only 85 or 57% had established IR functions. Of these 85 activities with IR functions 41 or 48% limited the IR staff to non-appropriated fund areas, payroll functions or other specific financial areas. By limiting the scope of the review, the activity, in NAS opinion, also limits its value to management and fails to meet the objectives of SECNAVINST 7510.8. This instruction emphasizes that IR is responsible for examining internal management controls, practices and procedures at all levels. In addition the review determines the adequacy in concept and effectiveness in applications of control measures [Ref. 4].

The problem is twofold; not only are many activities not using IR as a management tool but those that are using internal control fail to organize themselves so as to maximize the use of the function. The concept of IR is both new and misunderstood. In the author's opinion this causes managers to be naive as to how it should be used and what benefits can be reaped from its applications.

#### C. OBJECTIVE OF THE STUDY

The goal of this study is to select one of the larger Department of the Navy (DON) Commands without an IR function, and establish how it could best utilize an IR capability and design a model for how its IR function should be organized and perform.



The command chosen by the author is the Naval Military Personnel Command (NMPC). It was selected for the following three reasons: 1. most basically because it has no IR function. A report of the 17-28 March 1980 Command Inspection of the Commander, Naval Military Personnel Command specifically states, "Internal Review is not being performed by NMPC Headquarters" [Ref. 5]. The inspection report goes on to recommend that NMPC establish the capability for IR; 2. the large budget that NMPC handles in the Military Personnel (MPN) and Operations and Maintenance Appropriations (O&M) provides a large area for potential savings; and 3. the author has served at NMPC and thus has a good understanding and familiarity with the mission and organization.

In addition to the large budget that NMPC administers it also must execute several DON wide programs for personnel retention, reenlistment and career development which will enter the model as effectiveness, efficiency, and economy measures.

#### D. METHODOLOGY

Existing DON IR procedures were analyzed to determine their applicability to the NMPC organization. A library search was conducted to develop the history of IR and to establish the importance and need for IR. The NMPC organization was examined as it exists in the NMPC organization manual to establish a starting point for the formulation of an audit model.



A sample survey of public and private sector audit organizations and procedures in other personnel entities was conducted by individual correspondence. The purpose of the survey was to establish fundamentals of IR that were applicable to NMPC.

With the above data as a foundation, a model was developed for NMPC which outlines characteristics, policy, mission, structures, and control objectives. The model was established within the guidelines of generally accepted audit standards for both public and private audit agencies.

#### E. THESIS ORGANIZATION

Chapter II defines internal audit, briefly tracing its evolution in the government sector. Various levels of audit are examined as well as the importance and applicability of IR. Chapter III contains an overview of the NMPC structure as it currently exists, outlining NMPC's objectives and organization. The author establishes that NMPC does not have an IR function and examines the importance of developing such a function by outlining the areas of potential benefits. Chapter IV provides a summary of the author's research in the IR functions at personnel entities similar to NMPC. Chapter V presents the model calling on organizational theory concepts as well as standard operating procedures from existing IR organizations and generally accepted audit standards. The model establishes guidelines for technology, personnel, training,



command relationships and reporting which should be adopted by NMPC to optimize overall performance as well as the performance of the IR section alone. Chapter VI briefly presents possible problem areas in establishing and implementing an internal audit function, and presents general conclusions and recommendations.



## II. INTERNAL REVIEW

### A. INTRODUCTION

This chapter takes the definition of Internal Auditing presented in Chapter I and explains the different aspects and classifications of Internal Auditing and what their functions are. The concept of internal review (IR) is introduced, and the causes for the increased current emphasis on IR in both the public and private sector (depicted in Chapter I) are explored to explain the need and value of an IR capability [Ref. 6].

The next section clarifies the distinction made by the Department of Defense (DOD) in regard to the terms Internal Auditing and IR. The author then presents a content analysis of the current DOD and Department of the Navy (DON) internal audit directives, standards and policies outlining the scope, function and stated philosophy of DON internal audit/IR organizations.

The final section outlines the standards for the professional practice of internal auditing as viewed by the American Institute of Certified Public Accountants (AICPA), and the Institute of Internal Auditors, Inc (IIA). These standards are examined in relation to DOD, DON and the General Accounting Office (GAO) standards for commonality. The comparison depicts specific areas of importance that are essential to the professional execution of an IR entity.



## B. ASPECTS OF AUDITING

Auditing is the process of examining documents, records, reports, systems of internal control, accounting and financial procedures and other evidence for one or more of the following purposes:

### 1. Financial and Compliance Auditing

An examination, in accordance with generally accepted auditing standards, of financial transactions, accounts and reports, including an evaluation of compliance with applicable laws and regulations. Such examinations may lead to the expression on an opinion on the fairness of the presentation of financial statements in accordance with generally accepted accounting principles.

### 2. Economy and Efficiency Auditing

An evaluation of economy and efficiency relating to operations, administration, and management leading to specific citations of problem areas and when possible, recommendation for corrections or improvements.

### 3. Program Results or Effectiveness Auditing

An evaluation of program results leading to a statement of findings regarding the attainment of established objectives of the program of organization and when possible, including recommendations for improving effectiveness [Ref. 7].

Because of the necessity to inspect records and gather evidence in the execution of an audit, the literature reviewed by the author indicates the term auditor has long been



associated with negative connotations. Additionally, until relatively recent times most auditors were external to the entity and thus were looked upon as intruders [Ref. 8]. Various terms have appeared to help gain acceptance for the internal audit function in view of its rising importance. Business Week defines the new importance of the controller, Harvard Business Review outlines the rising importance of the internal consultant, while the accounting profession proclaims a new "role" for the internal auditor [Ref. 9]. There are many names for this area but the function is still the same: an in-house diagnosis of the performance of the entity.

As stated above auditing has three distinct aspects, although only the first, the fiduciary function of checking the books is widely recognized. The other two aspects of efficiency and effectiveness are at times separated from the auditing function and looked upon as a separate problem by management.

The focus of government auditing is changing. Auditing is no longer merely concerned with the appropriateness of financial records and compliance with legal requirements. Now the auditor is called upon to assess the economy, efficiency and effectiveness of program operations. These additional responsibilities are not only new, they are also challenging [Ref. 10].



### C. CLASSIFICATIONS

There are several classifications of audits. First, the obvious segregation of internal and external affiliation. A distinction as to whether the auditor is a member of the organization or is independent of the chief executive of the organization. Second, the classification is based on the time the examination is made, and divides audits into pre-audits and post-audits. A pre-audit is an examination of financial transactions prior to their completion, whereas a post-audit covers transactions that have been finally consummated [Ref. 11]. Third, are general and specific classifications dealing with the scope of the audit. General audits deal with all financial operations while specific audits deal with certain limited segments of the operation [Ref. 12]. The fourth and final classification is closely aligned with the third, audits are classified as complete or limited. Complete audits encompass a review of all financial records and transactions of an entity while a limited audit is conducted by sampling transactions of a unit and accepting the sample as representative of the entire group [Ref. 13].

### D. INTERNAL REVIEW EMPHASIS AND IMPORTANCE

The recent stress on IR affects both the private and public sectors. Recent legislation fixes responsibilities for waste, fraud and abuse with the director of the entity.



In addition to new legislation, branches of government such as the Office of Management and Budget (OMB), GAO and the relatively new Congressional Budget Office (CBO) are keeping a tab on the agencies and departments of the federal government to ensure not only their compliance with the law but also their efficiency and effectiveness as well.

A strong argument for IR is inflation. Webster defines inflation as, "an increase in the volume of money and credit relative to available goods, resulting in a substantial and continuing rise in the general price level" [Ref. 14]. The key phrase in this definition is continuing rise in the general price level.

The rising costs of goods have driven prices so high that it has dampened sales in many markets. This inability to raise prices as fast as costs has forced many firms to reduce their profit margins to risky levels. This author's literature search revealed that in order to reduce this risk corporations are turning inward and striving to increase productivity by improving efficiency and economy of operations.

In the government sector unbalanced budgets have contributed to inflation by deficit spending. This has forced every program, including such sacred cows as Social Security on the defensive for their very existence. The benefits of each program are being reviewed to determine their value in view of high inflation. If the shrinking dollar is



buying less then the government must ensure it is getting the most for its dollar.

At the same time that spending is being cut, funds are being reduced by tax cuts such as Proposition 13\* and President Regan's recent tax reform proposals. This two pronged attack on government spending has stressed the people's desire for efficiency.

The advent of internal audits to improve efficiency and economy of operation has not only helped reduce mismanagement but has brought to light many new sophisticated forms of white collar crime.

Watergate was the opening of the most recent flood gates, surfacing not only misdeeds at the highest levels of government but unbelievably poor accounting practices.

[Ref. 16]

The Foreign Corrupt Practices Act (FCPA) of 1977 requires that private firms devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances against abuse.

The role of the internal auditor has changed and increased because of the new cost differential of inadequate controls. The large penalties for non-compliance have

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\* Proposition 13 is a California Referendum to reduce State Property Tax.



reduced the real cost of internal auditors and increased their value. FCPA will probably accelerate an existing trend toward having internal auditors report to the highest levels of management [Ref. 16]. FCPA has also initiated self assessment of the control environment.

The next legislative step was the Inspector General Act of 1978 which established an Inspector General (IG) in 12 federal agencies, and consolidated auditing and investigative resources to combat waste, fraud and abuse. Each IG reports directly to the head of the agency or second in charge and has complete autonomy over audit topics. In addition the IG reports semi-annually to Congress. DOD was not included originally but because of increasing pressure, has instituted a new office of Assistant Secretary of Defense Review and Oversight which will report to the Deputy Secretary of Defense and will coordinate policy and procedures for DOD.

All of these pressures depict an expanding role for auditors and the recognition of their place on the "management team" rather than the preoccupation with the fiduciary function. Safeguarding of assets is indeed important but from a management perspective, it is less important than utilizing the assets in ways appropriate to attaining the entities goals [Ref. 17]. No longer are the auditors merely checking the books for correctness. They are becoming a consultant to top management. The benefit



of internal consulting is the ability to deliver high quality service with rapid response, accountability and at a lower cost than the external consultant/auditor [Ref. 18].

#### E. INTERNAL AUDITING IN THE DEPARTMENT OF THE NAVY (DON)

In 1949, Congress statutorily required the establishment of an internal audit capability in each military department and the Office of the Secretary of Defense by the passage of the National Security Act Amendments of 1949. Under this legislation the Secretary of the Navy was required to conduct internal auditing activities consistent with the operations and policies of the Comptroller of DOD. The DON established its own centralized internal audit organization, the Naval Audit Service (NAS) in 1952. At the same time, senior Navy officials recognized the need of field commanders for an in-house capability to identify problems and recommend solutions in financial areas within their commands. The DON Comptroller Manual was revised to address the creation of decentralized DON IR elements under the supervision of activity and installation commanders. IR personnel were initially assigned the following responsibilities:

1. Conducting special studies, analysis and investigations of areas under the jurisdiction of the local comptroller;
2. Performing audits of non-appropriated funds;



3. Assisting in correcting deficiencies revealed by internal audits;
4. Participating in the installation of financial and accounting systems;
5. Developing financial programs, procedures and controls;
6. Advising on the organization and staffing of the local comptroller office;
7. Maintaining liaison with NAS; and
8. Accomplishing annual reviews of civilian timekeeping and payroll functions. [Ref. 19]

In October 1976, Secretary of the Navy Instruction (SECNAVINST) 7510.8 entitled "Internal Review in the Department of the Navy," enlarged the scope of IR to include the examination of areas involving possible waste, fraud and abuse. Specifically, the instruction required the formulation of an IR office at all appropriate DON installations and activities, and charged the Auditor General of the Navy with developing and providing training and technical guidance to IR personnel. An important distinction that was made early on in the DON was that internal auditing is department wide while IR is to be done at the command or activity level. This distinction still is not clear to many commands and in the opinion of the Navy Comptroller (NAVCOMPT) personnel is the principal reason for the slow evolution of IR. In NAVCOMPT's opinion many people confused



IR with auditing and refused to instigate IR for fear that results of internal reviews would be reported to Congress annually with audit reports [Ref. 20]. NAVCOMPT has hired as of August 19, 1981 a director for IR policy and practices who is responsible for clarifying DON IR policy and establishing practices for the conduct of IR [Ref. 21].

#### F. DIRECTION AND POLICY

The internal audit system of the DOD was conducted under the auspices of the Assistant Secretary of Defense, Comptroller until March 1981 when the new office of the Assistant Secretary of Defense for Review and Oversight was established.

The original organization required the Secretary of each service to conduct internal audit activities consistent with the National Security Act Amendments and to report quarterly on the results of those audits. Guidance from DON on IR was broad enabling each service to tailor their review systems to their needs.

Management theorists profess that a clear organization, mission and functions are basic to sound management of any entity [Ref. 22]. Because of the diverse nature of the IR operation in the DON the author limits his presentation of DON policy and direction to the basics: 1. organization, 2. mission, and 3. functions. These three areas will present the key feature which should exist in a DON IR



system and will be the building blocks of the author's IR model.

# 1. Organization

No specific component of the DON's staff has specific responsibility to promulgate policy for and monitor the performance of IR offices in subordinate commands [Ref. 23]. The Navy employs a total of 472 professional internal reviewers. Of these, over three-quarters report to installation or activity comptrollers; the remainder are placed directly beneath their commanding officers. Ninety-eight percent of the DON's IR personnel are civilians; the remainder are naval officers and enlisted personnel. An indeterminate number of echelon\* 2 and 3 commands have IR staffs, which range in size from one to seven reviewers. The bulk of the DON's IR billets are assigned to field activities, which fall organizationally at echelon 4 and below. Interviews with personnel officers at various commands indicate that large installations with multiple and complex functions, such as shipyards and aviation rework facilities, typically contain IR staffs of six or seven civilian auditors and accountants. Their grades vary

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\* Echelon levels within the DON command structure refer to where a particular command sets in the chain of command. For example, Echelon 1 is the CNO staff, Echelon 2 would be the Naval Recruiting Command, Echelon 3 would be a Recruiting Area and Echelon 4 would be a Recruiting District.



from civilian pay scale GS-7 to GS-13. Smaller organizations with more modest missions may be served by IR groups composed of approximately one to three professionals within the same grade range [Ref. 24].

## 2. Mission

The mission of internal reviewers in the DON is to conduct special audits, analysis and investigations of financial and operational matters on behalf of their commanders. As such, they monitor the use of command resources in order to detect improprieties and inefficiencies and to recommend corrective measures [Ref. 25]. The specific functions performed by internal reviewers depend upon their location in the hierarchy of the DON. IR personnel at all levels fulfill the same general responsibilities.

Echelon 2 internal reviewer's issue a small number of review reports, but spend the majority of their time coordinating the efforts of external audit agencies and monitoring compliance with the audit recommendations of these organizations.

Echelon 3 IR staffs coordinate the follow up of external audit agencies findings, disseminate information concerning significant items disclosed by external audits and evaluate the annual review programs of IR groups at subordinate echelons.



All IR groups at or below Echelon 4 must prepare annual IR programs. An average group issues 15 to 25 formal reports annually. A typical report requires between 25 and 35 review days to complete. DON IR groups at these levels normally allocate their direct review time as follows:

[Ref. 26]

| <u>Areas of Coverage</u>                                    | <u>Percent of Time</u> |
|---|------------------------|
| Command Mission   | 25                     |
| Financial   | 27                     |
| Other Support   | 9                      |
| Non-Appropriated Fund Activities                            | 25                     |
| External Audit and Internal Review Follow-up and Compliance | 11                     |
| Miscellaneous   | <u>3</u>               |
| TOTAL   | 100                    |

### 3. Functions

The broad functional responsibilities of DON internal reviewers are:

#### a. Development of an Annual Program

A review program is prepared each year based upon available reviewer-days and time necessary to perform mandatory non-appropriated fund reviews. The program reflects recommendations from the installation commanders, their staff and subordinate elements as well as provide for review of deficiencies identified by external audit reports



and subjects scheduled for the previous year but not completed. The plan must allocate time for follow-up, compliance reviews and liaison activities. [Ref. 27]

The plan should identify who requested each review and include an explanation of its value, objectives and scope. The program should provide a schedule for completing the stages of the review and a statement of hours required for the study. [Ref. 28]

#### b. Performance of Reviews

An IR normally includes an evaluation of the activities compliance with applicable policies and procedures, the reliability of its records and reports, the accuracy of supporting documentation and the effectiveness of its operations. As a review progresses, responsible operating personnel must be kept fully informed of the findings. Operating personnel customarily may respond to review findings as they are discovered. At the conclusion of a review, the internal reviewers must conduct an exit conference with activity officials. Reviewers are expressly obliged to consider all the comments of the officials in preparing their final report of the IR. [Ref. 29]

#### c. Issuance of Internal Review Reports

An IR culminates in the preparation and issuance of a report. The report describes the scope, objectives and pertinent information of the review, including findings and recommendations. The report is submitted to



the installation commander who decides what action if any needs to be taken.

Report findings and recommendations must be fully supported by working papers. Reviewers should provide multiple recommendations whenever possible to afford commanders latitude in solving deficiencies. [Ref. 30]

In addition to IR reports an indeterminate number of reports are produced by ad hoc committees, which are formed to study specific programs, functions or activities. These committees exist for the length of the study and are then dissolved. Committee reports are very similar to permanent review reports and receive the same distribution and command attention [Ref. 31]. At times IR personnel are supplemented by technical specialists from within the command.

#### d. Performance of Follow-up

Follow-up is designed to determine if an activity has implemented corrective actions on the previous findings and recommendations of audit and IR reports. Commands that have an IR activity require elements that have been audited or reviewed to submit feedback to the comptroller on the status of corrective action. Most commanders expect deficiencies to be rectified within 90 days after the issuance of an audit or IR report [Ref. 32]. Comptrollers can accept the assurance of the element that corrective action is completed or can require the IR staff



to assess the effectiveness of the element's remedial actions.

e. Liaison with External Audit Organization

Navy Commanders normally designate their IR staffs to be the spokesman in dealings with GAO, DOD Audit Service, NAS, and other external review organizations. This liaison includes coordinating entrance and exit conferences, arranging for administrative support, monitoring progress, and assisting command managers in formulating responses to external group findings and recommendations. [Ref. 33]

The new office of the Assistant Secretary of Defense for Review and Oversight has not promulgated any policy guidance yet but early indications from that office are that the staff would become very involved with enforcing the use of IR at all levels within DOD. It is not anticipated that any policy changes will occur in the organization, mission and functions of IR activities as they currently exist. [Ref. 34]

Exhibit II-1 summarizes the key features of current DON practices in the execution of IR policy.

G. STANDARDS

The term standard as used in this thesis means the criteria by which the operations of an IR department are evaluated and measured.

There are three widely accepted sets of standards for IR. The first set was published by the American Institute



# EXHIBIT II-1

## SUMMARY OF DON INTERNAL REVIEW PRACTICES

| <u>ORGANIZATION</u>            | <u>MISSION</u>                                 | <u>FUNCTION</u>                         |
|--------------------------------|--|---|
| Reports to unit C.O.           | Special audits                                 | Prepare annual review program           |
| Professional internal reviewer | Analysis of Command Mission                    | Fiduciary review                        |
| Civilian                       | Investigations of financial matters            | Efficiency review                       |
| Exists at echelon 4 or below   | Review of operations                           | Effectiveness review                    |
| GS-7 to GS-13                  | Non-appropriated funds audits                  | Issue reports                           |
| 1-7 personnel                  | Develop new financial programs and controls    | Follow-up and compliance                |
|                                | Annual civilian timekeeping and payroll review | Coordination with external audit groups |



of Certified Public Accountants (AICPA), the second by the Institute of Internal Auditors, Inc. (IIA) and the third by the GAO. Until 1972 GAO used the standards as published by the AICPA. GAO originally adopted the AICPA standards because of the high degree of relevance to the work of federal auditors [Ref. 35].

All three variations of the standards are very similar. GAO and AICPA standards are organized very much the same way but the AICPA does not recognize work done in reviewing compliance, efficiency and effectiveness.

Since this report is concerned with the IR procedures of a government unit, the author will describe the GAO standards pointing out significant differences from the AICPA standards. The next section will describe the IIA standards and their relevance and similarity to the GAO standards.

## 1. GAO Standards

The standards are classified according to three broad categories; general, examination and evaluation, and reporting.

### a. General Standards

The general standards are concerned with the auditors' qualifications and the nature of their work, but include standards for an audit of much broader scope than would be applicable to private sector audits.



The first general standard identifies the scope of an audit. The GAO considers all three aspects of auditing, fiduciary, economy and efficiency, and program effectiveness but the AICPA standards recognize only examinations of financial reports.

The second general standard deals with auditor qualifications calling for professional proficiency to perform the tasks required. This standard implies that audits should be done as a team so that specialists can be used to collectively achieve proficiency.

The third general standard requires the independence of the auditor and the audit organization.

The fourth general standard requires the auditor to exercise due professional care while both conducting the audit and preparing the related reports.

#### b. Examination and Evaluation Standards

These standards describe the auditors' objective and subjective evaluations in providing financial, compliance, and operational information to report users.

The first standard requires that work be adequately planned. The second applies to the proper supervision of assistants. The third standard is closely related to defining the scope by requiring a review be made of compliance with legal and regulatory requirements. The fourth evaluation and examination standard ensures that the systems of internal control are assessed to determine their



reliability and accuracy. The final standard requires that sufficient, competent and relevant evidence be obtained to support the auditors' conclusions and recommendations.

While most of these standards are similar to the AICPA's the third standard relating to the scope of the audit is a variation.

#### c. Reporting Standards

These standards refer to report transmission, preparation, content, and quality. The GAO reporting standards differ considerably from those of the accounting profession.

The first standard requires that audit reports be submitted to the appropriate officials of the audited organization, and to others who may be responsible for taking action on audit findings.

The second reporting standard refers to timeliness, ensuring that reports are issued on or before the date specified by law, regulation or other arrangement and in any event as soon as possible.

The third standard specifies several concepts that should be included in all audits as generally accepted principles. This standard requires reports to be clear and concise yet complete enough to be understood. Reports should be factual and fair. Auditors should include, when possible, recommendations for improvements. Improvement should be the primary concern rather than criticism. Reports



should identify areas for further study and areas of noteworthy achievement. The report should identify the scope and objective of the audit. Finally the report should give recognition to the pertinent comments of responsible officials of the audited organization, and detail whether information has been omitted of a confidential or privileged nature.

The fourth and final reporting standard requires the auditor to state an opinion as to whether the information is presented fairly and in accordance with generally accepted accounting principles. [Ref. 36]

The GAO reporting standards variance from the AICPA standards can be traced to the difference in scope. GAO requires review and comment on a broader plane than the AICPA. The GAO wants more than an opinion on the fairness of the presentation of financial information.

## 2. IIA Standards

The internal auditing department is an integral part of an organization and functions under the policies established by management. These standards are meant to serve the entire profession in all types of business, in various levels of government, and in all other organizations where internal auditors are found. The IIA espouses five general standards each comprised of several specific standards. These standards differentiate among the varied responsibilities of the organization, internal auditing department,



director of internal auditing and internal auditors. The following is a summary of the general and specific standards.

a. Independence

Internal auditors should be independent of the activities they audit. Specifically, they should remain objective in performing audits and should maintain an organizational status that is sufficient to permit the accomplishment of audit responsibilities.

b. Professional Proficiency

Internal audits should be performed with proficiency and due professional care. Specifically the internal auditing department should ensure they are staffed with auditors who have the proficiency and skills in the disciplines necessary to carry out audit objectives. Further, the internal audit department should provide guidance and supervision to its auditors. The internal auditors must comply with standards of conduct, be skilled in human relations, and communications as well as audit disciplines. Internal auditors should exercise professional care in the execution of their audits and should promote their own technical competence through continuing education.

c. Scope of Work

The scope of the internal auditor should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out



assigned responsibilities. Specifically internal auditors are responsible for the reliability and integrity of the financial information, including whether it complies with policies, plans, procedures, laws and regulations. Further, internal auditors must review the means of safeguarding assets, efficient use of resources, and accomplishment of objectives or programs.

d. Performance of Audit Work

Audit work should include planning the audit, examining and evaluating information, communicating results and following-up. Each audit should be individually planned, resulting information should be analyzed and interpreted before reporting the results of the audit. Reported findings should then be followed-up on to ascertain that appropriate action was taken.

e. Management of the Internal Auditing Department

The director of internal auditing should properly manage the internal auditing department. This is a "Motherhood" standard which requires that the director specifically publicize a statement of purpose, authority and responsibilities for the internal auditing department. The director is responsible for establishing plans, policy, procedures and quality assurance. The director must establish a program of personnel management and development internal to the auditing department. And finally, the director coordinates internal and external audit efforts. [Ref. 37]



There are many characteristics of the three sets of standards which are similar. Exhibit II-2 provides a comparison between the standards. It is intended as a summary and highlights the fundamental importance of certain characteristics.

#### H. SUMMARY

This chapter has established the importance of the IR function by depicting the relevance in both public and private sectors. The author points out that DOD draws a distinction between IR and internal auditing. The basis of the difference is at what level in the organization the audit occurs. Internal audit is DON-wide, IR is contained within each individual entity. The author then lays out in detail the various aspects of an IR including classifications and definitions.

With the meaning and importance of IR established as a basis for the thesis, the author proceeds to DOD policy, and reviews the current DOD policy and DON practices in the execution of IR. Exhibit II-1 summarizes the practices used in the DON to conduct IR including organization, mission and function. These practices provide a basis for the structure of a model to be used by any DON IR unit.

The final section compares standards for the execution of an audit for the public and private sectors and the standards for IR as published by the IIA. These standards



## EXHIBIT II-2

## CHARACTERISTICS OF AUDIT STANDARDS

Key ideas presented in each of the standards as they relate to specific characteristics of an audit or internal review.

| <u>CHARACTERISTIC</u>             | <u>GOVT/GAO</u>                          | <u>PRIVATE<br/>AICIA</u>            | <u>INTERNAL<br/>IIA</u>  |
|-----------------------------------|--|-------------------------------------|--|
| SCOPE                             | Fiduciary<br>Effectiveness<br>Efficiency | Fiduciary                           | Fiduciary<br>Effectiveness<br>Efficiency                           |
| AUDITOR QUAL-<br>IFICATIONS       | Professionalism<br>Teamwork              | Professionalism<br>Teamwork         | Professionalism<br>Teamwork<br>Competence<br>Communication<br>Tact |
| INDEPENDENCE                      | Objectivity                              | Objectivity                         | Objectivity  |
| PROFESSIONAL<br>CARE              | Audits and<br>Reports                    | Audits and<br>Reports               | Audits and<br>Reports<br>Standards of<br>Conduct                   |
| AUDIT<br>PLANNING                 | Preparation                              |                                     | Preparation  |
| SUPERVISION                       | Guidance                                 | Guidance                            | Guidance   |
| COMPLIANCE                        | Laws<br>Regulations                      | Laws                                | Laws<br>Regulations<br>Plans<br>Policy                             |
| ASSESS INTERNAL<br>CONTROL SYSTEM | Reliability<br>Accuracy                  |                                     | Reliability<br>Accuracy<br>Adequacy                                |
| EVIDENCE                          | Sufficient<br>Competent<br>Relevant      | Sufficient<br>Competent<br>Relevant | Sufficient<br>Competent<br>Relevant                                |
| SUBMISSION<br>PROCEDURES          | Appropriate<br>Official                  | Appropriate<br>Official             |  |



## EXHIBIT II-2

CHARACTERISTICS OF AUDIT STANDARDS  
(Continued)

| <u>CHARACTERISTIC</u> | <u>GOVT/GAO</u>  | <u>PRIVATE<br/>AICIA</u>   | <u>INTERNAL<br/>IIA</u>  |
|-----------------------|--|--|--|
| TIMELINESS            | On or Before<br>Specified Date   |  |  |
| COORDINATION          | External Audits  | External Audits  | External Audits  |
| CONCEPTS              | Clear<br>Concise<br>Complete<br>Understood<br>Recommendations<br>Stress Positive<br>Areas of Further<br>Study<br>Areas of Achievement<br>Identify Scope &<br>Objective<br>Fair<br>Presentation | Clear<br>Concise<br>Complete<br>Understood<br>Recommendations<br>Stress Positive<br><br>Fair<br>Presentation | Clear<br>Concise<br>Complete<br>Understood<br>Recommendations<br>Stress Positive |



provide a criterion to measure the performance of an IR activity and establish the primary characteristics that are essential to an IR activity. Again for the readers convenience these characteristics are summarized in Exhibit II-2. Chapter III will now provide background information on the Naval Military Personnel Command (NMPC).



### III. NAVAL MILITARY PERSONNEL COMMAND

#### A. INTRODUCTION

This chapter presents background information on the Naval Military Personnel Command (NMPC). The author first establishes that NMPC currently has no internal review (IR) capability, and then establishes the current command organization, mission and functions of NMPC as well as that of the NMPC Comptroller and Financial Management Departments.

The current Comptroller organization is studied to present a starting point for developing an IR model which will be compatible with the present NMPC organization structure.

The mission and functions of NMPC are studied in the next section to discover areas that could benefit from an IR division. Similar functions in different departments are highlighted and presented as areas for potential gain.

Finally the current budget of NMPC is outlined to establish the magnitude of possible benefits.

#### B. NAVAL MILITARY PERSONNEL COMMAND

##### 1. Background

NMPC was established in fiscal year 1979 as a result of extensive research by Booz, Allen, and Hamilton Inc., a civilian contractor, and the Salzer Study, a report submitted by Vice Admiral R. E. Salzer, USN, (RET), on



reorganization of the Chief of Naval Personnel (CNP). The result of these studies was the realignment of CNP into two distinct entities: first the Deputy Chief of Naval Operations for Manpower, Personnel and Training (OP-01) and second NMPC.

## 2. Mission

OP-01 is headed by CNP and has the following mission:

to implement the responsibilities of the CNO for the management of planning and programing of MPT resources, budgeting for military personnel and appraisal of the Navy's total force manpower, personnel and training (MPT) programs; to develop systems for requirements determination of total force MPT resources and allocation of military personnel; to serve as principal advisor on MPT matters and exercise centralized coordination and control of professional standards criteria, and religious ministry. [Ref. 38]

With OP-01 responsible for planning, programing and budgeting functions, an activity was needed to execute the policies of CNP. NMPC was formed to meet this need.

NMPC was designed after similar entities in the Air Force and Army personnel structures. It is responsible to OP-01 for the following mission:

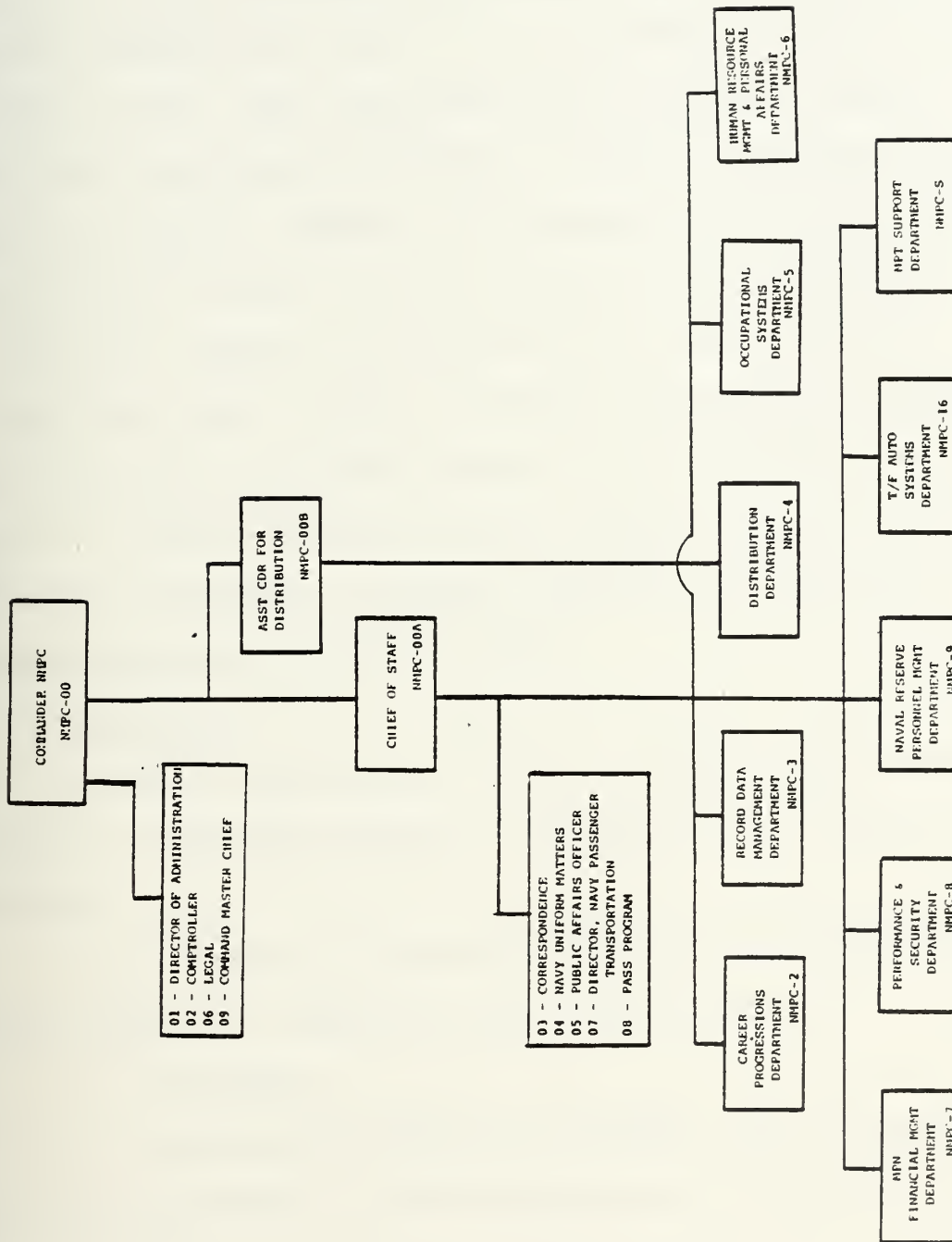
to perform officer and enlisted personnel distribution, career development, personnel administration, and such other operational functions as may be assigned in support of the mission of the Chief of Naval Personnel. [Ref. 39]

## 3. Organization

The organization of NMPC is laid out along functional responsibility lines. Exhibit III-1 depicts the current organization of NMPC. The distribution function, identified as the key mission of NMPC is also the largest segment of



# EXHIBIT III-1 NMPC ORGANIZATION





the organization and is headed by an O-7\* who reports directly to the Commander of NMPC who is an O-8. Other functional elements of the organization are headed by civilian and military directors who report to the Commander via the Chief of Staff, an O-6. The Commander has an immediate support staff that also reports directly to the top and advises on legal and financial matters. The legal support is provided by an O-6 and a staff of civilian and military personnel. The financial support is provided by the Comptroller a civilian GS-15 and a staff of civilian and military personnel. Two others also have direct access to the Commander, a Director of Administration and the Command Master Chief who informs the Commander on matters pertaining to the large enlisted complement working at NMPC.

#### 4. Functions

Although the mission of NMPC is simply and succinctly stated the functions required to accomplish that mission are numerous.

The functions do parallel the organizational lines and the author will address them in that order.

##### a. Commander

Directs the operation of NMPC, and is responsible to the Commandant of the Marine Corps and the heads of

---

\* O-7 and O-8 are designations for Navy Rear Admirals upper half (O-8) and lower half (O-7). O-6 is a Navy Captain.



other Department of the Navy (DON) organizations in meeting particular needs within their areas of responsibility and to discharge other responsibilities which may be assigned by higher authority.

b. Assistant Commander for Distribution (NMPC-4)

Provides personnel manning for activities, commands and programs administered by NMPC or which may be assigned by the Chief of Naval Operations (CNO). The distribution branch also assists major claimants in planning and programing personnel support facilities.

c. Comptroller (NMPC-02)

Acts as the command's central point of contact with external organizations in matters of financial management. In conjunction with NMPC-7 provides budget, accounting, and reports for programs assigned and controls obligations and expenditures of appropriated funds allocated to approved programs.

d. Career Progressions Department (NMPC-2)

Administers the advancement, retirement and distribution of regular Navy personnel.

e. Records Data Management Department (NMPC-3)

Maintains service records of active Navy personnel and provides a military, manpower and personnel management information system for the DON.



f. Occupational Systems Department (NMPC-5)

Maintains and administers a structure of officer and enlisted classifications to provide a sound basis for manpower and personnel management and administration in the DON.

g. Human Resource Management and Personal Affairs Department (NMPC-6)

Administers those functions prescribed by law involving benefits for Navy personnel and their dependents. Is responsible for the management of non-appropriated funds available for the welfare and recreation of Navy personnel. Implements and manages programs for improved human relations.

h. MPT Support Department (NMPC-S)

Provides specific administrative, technical and office services support for OP-01.

i. Performance and Security Department (NMPC-8)

Provides DON-wide administrative support and technical guidance for performance and discipline matters and is responsible for the operation of DON places of confinement.

j. Naval Reserve Personnel Management Department (NMPC-9)

Coordinates and administers personnel matters for members of the Naval Reserve on inactive duty including standby, ready and selected reserves and active duty TARs.



k. Total Force Automated Systems Department (NMPC-16)

Provides ADP support for personnel information systems for OP-01, NMPC and the Naval Civilian Personnel Command. [Ref. 40]

Many of the functions assigned to elements of the organization cross lines of authority or exist in other organizational elements to achieve the same purpose or additional goals. For example NMPC-9 duplicates many of the activities of NMPC-5 in maintaining a classification structure but does it for the reserve population instead of the active duty contingent. Since funds are separated for Operations and Maintenance Navy (O&MN) and Operations and Maintenance Naval Reserve (O&MNR) similar accounting and budget activities occur in these areas. Exhibit III-2 displays the similar functions that exist in different organizational elements of NMPC.

C. NMPC INTERNAL REVIEW CAPABILITY

The central question of this research asks what an IR department should look like for a personnel command that does not have one established. In this section the author establishes that NMPC does not have an IR capability and establishes the current reasons for that lack of capability as well as proposed plans for the future.

In March 1980 the Naval Inspector General (IG) and staff conducted a Command Inspection of the NMPC. On the subject



# EXHIBIT III-2

## NMPC FUNCTIONS

### ELEMENT

| ASST FOR<br>DISTRIBUTION                                 | CAREER<br>PROGRESSIONS                                   | RECORD DATA<br>MANAGEMENT                                | COMPTROLLER  |
|--|--|--|--|
| Liaison  | Liaison  | Liaison  | Liaison with External<br>Audit Agencies  |
| Analysis   | Analysis   |  | Analysis   |
| Monitor Compliance<br>Management and<br>Control of Funds | Monitor Compliance<br>Management and<br>Control of Funds | Monitor Compliance<br>Management and<br>Control of Funds | Monitor Fiscal System<br>Fiduciary & Management<br>Control of Funds                          |
| Measure Performance                                      |  | Measure Performance                                      | Measure Performance  |
| Special Projects   |  |  | Management Studies   |
| Review Procedures  | Review Programs  |  | Review Resource<br>Requirements  |
| Assess Policy  |  |  | Accounting   |
| Accounting   |  | Administer Contracts                                     |  |
| ADP  | Develop Policy   | Develop Policy   | Economic Analysis<br>Review Civilian<br>Timekeeping & Payroll<br>Review Internal<br>Controls |



EXHIBIT III-2

NMPC FUNCTIONS  
(Continued)

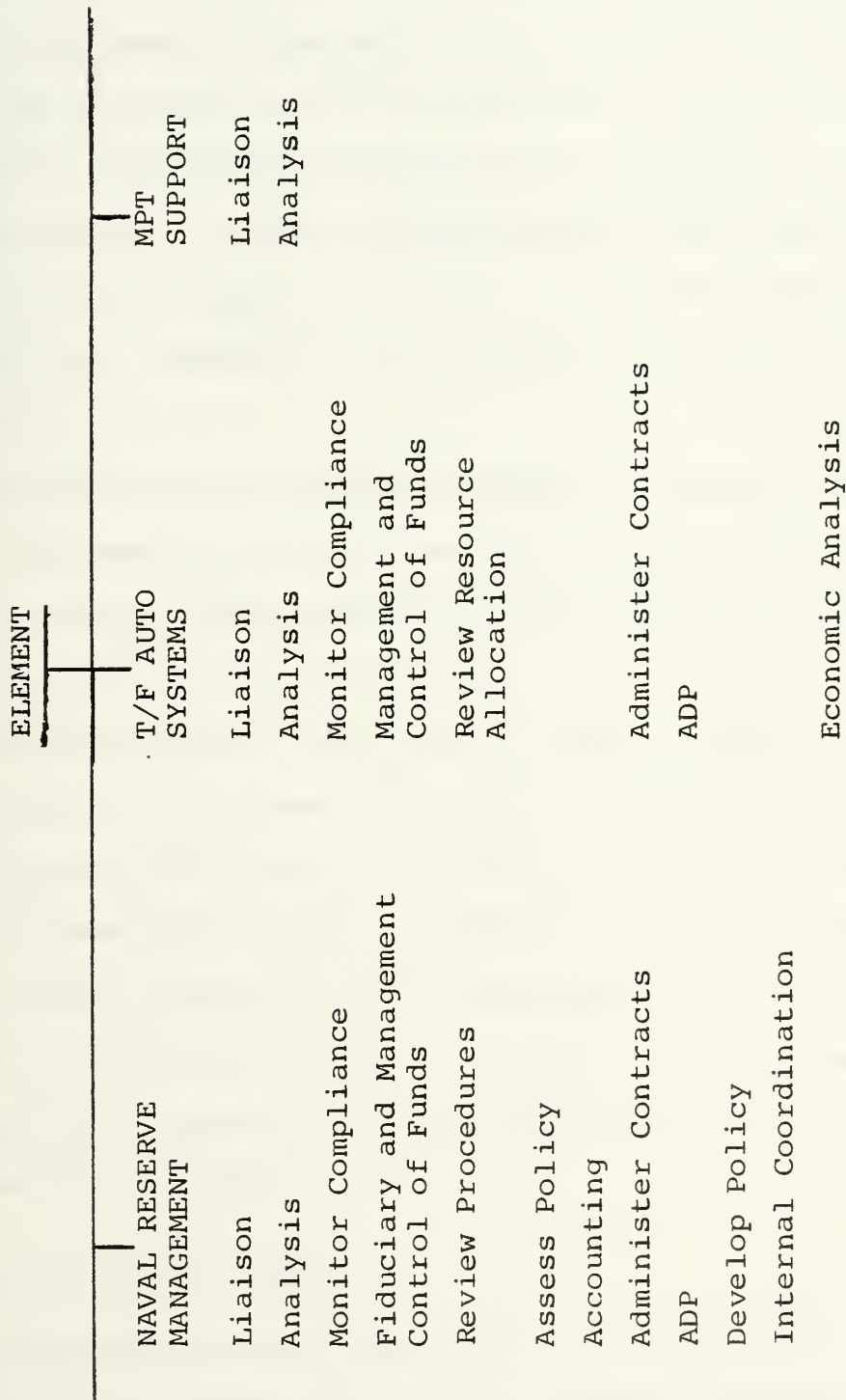
ELEMENT

| OCCUPATIONAL<br>SYSTEMS | HUMAN<br>RESOURCES                              | MPN FINANCIAL<br>MANAGEMENT                     | PERFORMANCE &<br>SECURITY |
|-------------------------|---|---|---------------------------|
| Liaison                 | Liaison   | Liaison   | Liaison                   |
| Analysis                | Analysis  | Analysis  |                           |
| Monitor Compliance      | Monitor Compliance                              |   | Monitor Compliance        |
|                         | Fiduciary and<br>Management<br>Control of Funds | Fiduciary and<br>Management<br>Control of Funds |                           |
| Measure Performance     | Measure Performance                             |   | Measure Performance       |
| Special Studies         | Special Studies                                 | Special Studies                                 | Special Studies           |
| Review Programs         | Review Procedures                               |   | Review Procedures         |
| Assess Policy           | Assess Policy                                   |   | Assess Policy             |
|                         | Accounting                                      | Accounting                                      |                           |
|                         | Administer<br>Contracts                         |   |                           |
|                         | Supervise Audits                                |   | Oversight                 |
|                         | Financial Analysis                              |   |                           |
|                         | Review Internal<br>Controls of NAF              |   |                           |



# EXHIBIT III-2

## NMPC FUNCTIONS (Continued)





of IR the inspectors found no mention of IR in the organization manual and no evidence of it being performed by either the Comptroller or the Military Personnel Navy (MPN) Financial Management Department. The inspection team stated: IR as prescribed by SECNAV policy is not being performed by NAVMILPERSCOM Headquarters [Ref. 41]. The inspection report further recommended that NMPC establish an organizational capability for IR within both NMPC-02, the Comptroller and NMPC-7, the Financial Management Department.

In response to this discrepancy NMPC commented that IR billets had been requested in both FY 81 and FY 82 budgets but OP-01 had cut these billets. As a result NMPC has no IR staff to analyze its operations.

As an update NMPC 02 is acting on this inspection discrepancy by having position descriptions classified for IR and has requested two IR billets in the FY 83 Program Objectives Memorandum (POM). Further, NMPC-02 has prepared an IR directive and will issue the directive if OP-01 approves two GS-510 IR billets. GS-510 is a civil service designation for accounting series positions which includes accountants and auditors.

#### D. NMPC COMPTROLLER (NMPC-02)

The preceeding section has given the broad scope of NMPC and defined its overall mission, and general functions. In



this section the author delves in detail into one of the two major financial departments in NMPC, the Comptroller. In the next section the author will address the other financial segment, MPN Financial Management Department.

## 1. Organization

The organization of NMPC-02, the Comptroller Department is portrayed in Exhibit III-3. The organization identifies four major divisions within the Comptroller's perview, Programming and Budget, Financial Control, Claimancy Control and Analysis and Management Services. In terms of functional responsibilities the NMPC organization manual assigns the majority of Comptroller functions to the Programming and Budget Branch and the Claimancy Control and Analysis Branch.

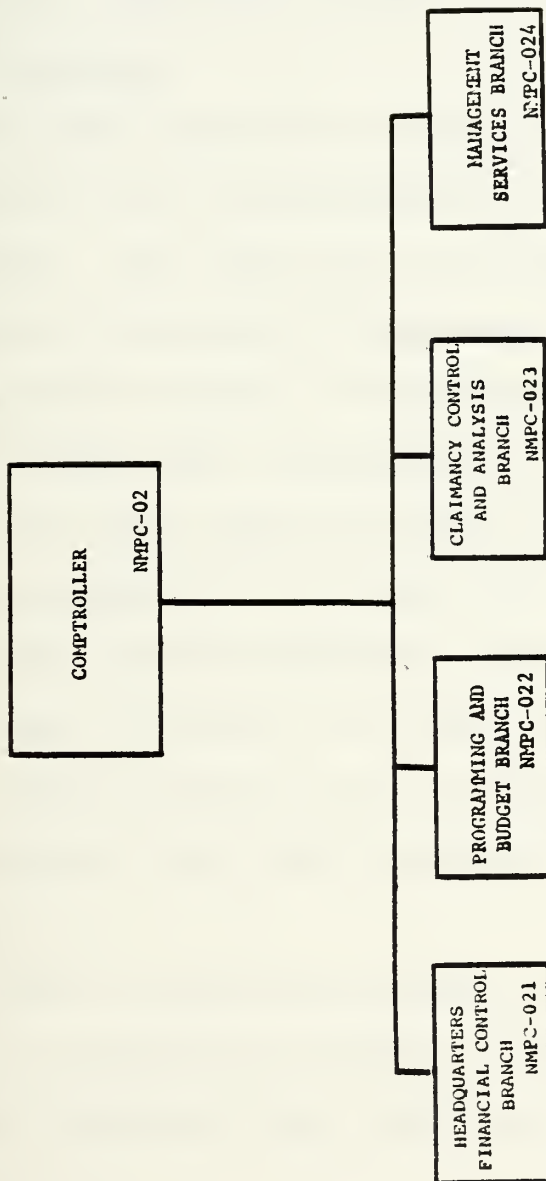
## 2. Mission

Develops, coordinates, and maintains an integrated system of staff services in the financial and general management areas that will provide to the Commander the factual data essential for effective management control; formulates the claimancy Five Year Defense Plan (FYDP), Program Objectives Memorandum (POM), civilian and military manpower plans and budget; compares program performance with the financial plan, analyzes variances therefrom and determines where financial reprogramming may be required; is responsible for the conduct of accounting, progress reports and statistics, and exercises such claimancy fiscal review and control as necessary; acts as the commands central point of contact with external organizations in matters of financial management; provides management staff assistance to NMPC managers, subclaimants and field activities; administers and monitors all elements of the Navy Records Management Program as applied to NMPC, subclaimants, and field activities. The Comptroller holds 3679, R.S. administrative responsibility for claimancy O&MN, O&MNR, and OPN funds except when specifically passed to subordinate organizations and activities. [Ref. 42]



EXHIBIT III-3

NMPC-02 ORGANIZATION





Key areas of the Comptroller mission fit into the aspects of IR as defined in Chapter II, specifically program performance studies, financial accounting, fiscal review, and effective management control. The mission calls for actions which taken collectively make up the act of IR.

### 3. Functions

The NMPC organization manual details 50 specific functions that are the responsibility of the Comptroller organization. The functional statements go into great detail on the execution of the Comptroller mission. The author selected several of the functions to discuss below in order to show their adaptability to IR.

One of the functions specifically calls for the design and application of audit control checklists for IR. The Claimancy and Control Branch (NMPC-023) is required to perform annual reviews of the NMPC civilian timekeeping and payroll function which is one of the areas that was identified as common to the DON IR mission (see Exhibit II-1 and Reference 19).

Three of the four branches in the Comptroller organization are required to conduct analysis of budget variations and review resources usage areas which is again common to the DON IR mission.

Because of the Comptroller's responsibilities for accounting, and fiduciary and managerial control of funds it should have an in-house check on its procedures [Ref. 43].



This check will help catch problems rather than having them discovered during an external audit by the Naval Audit Service (NAS) or Government Accounting Office (GAO). This could save unwarranted and unwanted publicity.

Another of the common missions of IR in the DON is the development of new financial programs and controls. At NMPC this activity is the responsibility of the Comptroller shop. Additionally the Comptroller acts as the command liaison with external auditors which is also a function common to DON IR activities.

The Comptroller has established functions in existence that cover all the common missions of a DON IR activity except the auditing of Non-Appropriated Funds (NAF). NMPC-652 which is the financial management arm of the Recreation Services Division is tasked with this responsibility for both NMPC and DON-wide NAF.

The Comptroller is tasked with the execution of these IR functions for the O&M and Other Procurement Navy (OPN) funds, two of the major funds under the auspices of NMPC. Although the Comptroller is responsible for the execution of these standard IR activities, the IG has declared that they are not being done. Another alternative is that the functions are being executed but are not centralized and identified as IR by the NMPC overall organization. The goal of the author is not to comment on the competency of the current organization but rather to use it as a basis



for developing a theoretical example of how an IR unit could be established for NMPC.

The Comptroller's organization offers no handicap or obstacle to the addition of a fifth branch responsible for IR. The mission of the Comptroller requires the accomplishment of activities that are common to the professional practitioners of IR. Finally several of the stated functions of the Comptroller are identical to tasks performed by IR activities in other commands. One of the functions goes as far as to call on the Claimancy and Control Branch (NMPC-023) to conduct IR.

#### E. NMPC MPN FINANCIAL MANAGEMENT DEPARTMENT (NMPC-7)

Like the Comptroller, the MPN Financial Management Department, reports to the Commander on the status of funds. NMPC-7 is responsible for the MPN appropriation which supports the military pay, permanent change of station and retired pay requirements.

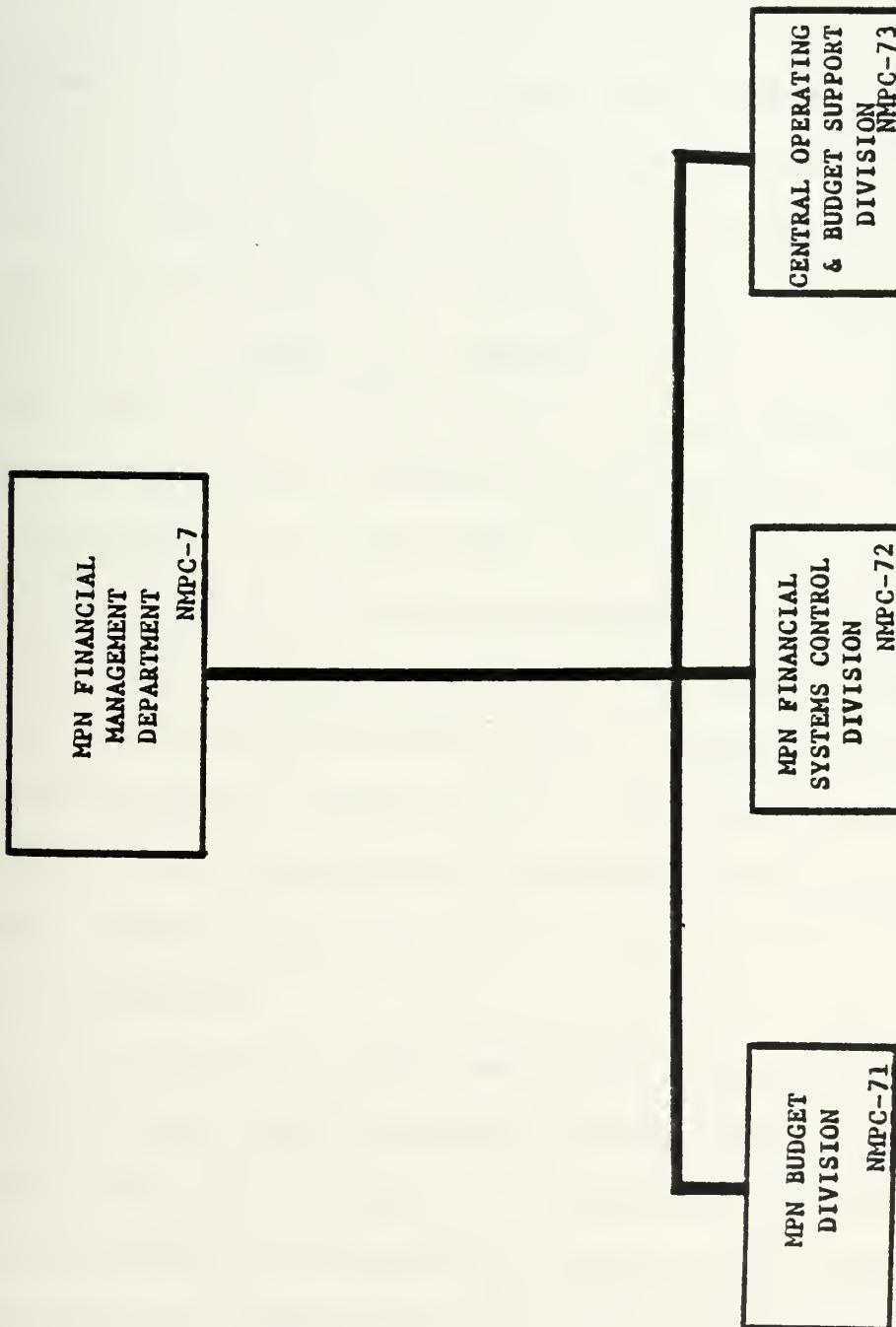
##### 1. Organization

The organization of NMPC-7 is portrayed in Exhibit III-4. The organization is small and consists of three divisions, the MPN Budget, MPN Financial Systems Control, and Central Operating and Budget Support Divisions. The current head of NMPC-7 is an O-6 and the deputy director is a civilian. The Budget Division contains the most people and has the majority of the functions assigned by the NMPC organization manual.



EXHIBIT III-4

NMPC-7 ORGANIZATION





## 2. Mission

To coordinate development of the MPN appropriation, portions of Retired Pay Navy (RPN), and Defense total force budget, to prepare the appropriate budget submissions and to monitor performance against the approved budget. [Ref. 44]

Unlike the Comptroller's mission, the MPN Financial Management Department mission does not spell out common areas of application to IR. Monitoring the performance of the budget against approved total would be the only facet of the mission that would correlate with the common practices established in Chapter II. However, since both the Comptroller and NMPC-7 have similar tasks in the management of funds it is interesting to note the large disparity in their mission statements. It would seem that the only difference should be in fund title and areas such as civilian payroll which is strictly related to O&M. This inequity leads the author to believe that there is not a clear statement of mission for NMPC-7. Taken at face value the mission does not show a clear cut need for IR, which after a second look does not appear to be true.

## 3. Functions

In contrast to the numerous functions listed for the Comptroller, NMPC-7 has only 14 functions listed in the command organization manual. In contrast to the brief mission statement, the functions specify what the NMPC-7 objectives are. Even though the functions are more specific than the mission they do not list any activities that would



benefit from IR other than general analysis. However, the author notes that NMPC-7 has no stated functional responsibility for fiduciary control of MPN funds; nor is there a requirement to develop financial programs or controls for the MPN fund. This could be accomplished by the Comptroller for all of NMPC-7 but it is not stated as such in the organization manual.

Even if the only function that is adaptable to IR is analysis, the magnitude of the MPN budget makes analysis an area of potentially large gains.

#### F. FUNCTIONAL AREAS OF BENEFIT

##### 1. Introduction

The functions presented in Exhibit III-2 occur at different frequencies. Some of the functions are common to almost all the branches while others correspond to only a few branches. For example, liaison is the most common function. It occurs in every branch. Although Exhibit III-2 portrays a commonality of liaison, the function can actually be very different. The liaison can be within NMPC, external to the command or even outside the DON. The branches do have a common bond of working with organizations outside their branch.

The author has generalized the functions that are common to show the degree of similarity between the functions of different branches and to depict areas that are suitable for assumption or assistance by an IR activity.



The activities or functions that are most prevalent at NMPC are liaison, analysis, monitoring compliance, management and control of funds, performance measurement, special studies, and reviews.

## 2. Applicability of Common Functions to Internal Review

### a. Liaison

This function appears in every branch but has only one application to IR. The Comptroller conducts liaison with external audit agencies. This is a delegated responsibility of DON IR [Ref. 45]. Since the Comptroller conducts liaison with external audit agencies already, it is presently a recognized benefit by the Comptroller to have a central point of contact.

### b. Analysis

This function exists in almost every branch of NMPC. Analysis involves the study of situations and determining the nature of variances or causes of problems. DON policy delineates analysis as one of the responsibilities of IR [Ref. 46].

So many branches at NMPC utilize analysis within their organizations that it appears to be recognized as a benefit by the numbers of users.

### c. Monitoring Compliance

Monitoring is also a very common function within NMPC but is not stated specifically as a responsibility of DON IR. Since NMPC is a field activity of OP-01 it must be



concerned with compliance since OP-01 sets most of the policies for NMPC. While it is not a required DON IR activity it can be looked on as a control measure in the accomplishment of the NMPC mission. The purpose of internal auditing as presented in Chapter I is to assist members in the effective discharge of their responsibilities [Ref. 47].

#### d. Management and Control of Funds

Management and Control of Funds, in the author's opinion does not lend itself to IR directly. It is a separate function. While aspects of management may be analyzed or reviewed it is not applicable to IR.

#### e. Performance Measurement

Performance Measurement like monitoring compliance is an appraisal of the activity. As such the author groups performance measurement and monitoring compliance together as applicable to IR for the evaluation of accomplishments by the entity.

#### f. Special Studies

Studies are an appropriate function for IR and is a specifically stated responsibility of IR in DON [Ref. 48]. Conducting studies as directed by higher authority can be used in any number of ways to benefit the organization in the accomplishment of its goals. This could involve the evaluation of a new computer system or research of the Permanent Change of Station (PCS) program.



#### g. Review

The author presents review as one function but it is applied in several ways. Review involves the inspection of procedures, programs, and resource requirements. Review like monitoring and performance measuring are controls used to benefit the accomplishment of the command mission [Ref. 49].

### 3. Applicability of Less Common Functions

There are several functions that are performed by various branches within NMPC that while they are not common to all branches still in the author's opinion lend themselves to IR. Most of these independent functions are performed by the Comptroller. The author has chosen to address only those functions from Exhibit III-2 that in his opinion would lend themselves to IR and would provide benefits. These functions are economic analysis, review of civilian timekeeping and payroll, review of internal controls, accounting, and administering contracts.

As outlined in DON policy most of these functions fall directly within the scope of IR. Secretary of the Navy Instruction 7510.8 entitled "Internal Review in the Department of the Navy" calls on IR to perform reviews of civilian timekeeping and payroll, accounting and economic analysis. Review of internal controls fits into the definition of IR in that it is a review of the internal management controls, in order to determine adequacy in concept and effectiveness



in application [Ref. 50]. Accounting fits into the first aspect of auditing, in that it is a review to determine if the statements are in accordance with generally accepted accounting principles [Ref. 51]. Administering contracts does not fall into any area that is directly related to IR. Functions such as measuring performance, analysis, accounting and review are all means to evaluate the administration of a contract and are thus the more applicable functions to supply benefit.

The numerous functions of NMPC have been summarized and reduced to show commonality. Some of these functions although similar in name are distinct in execution and for the most part lend themselves to IR as outlined above regardless of the method of execution. The primary benefit is their aid to management in the effective discharge of their responsibilities [Ref. 52].

## G. NMPC BUDGET

### 1. Introduction

NMPC has four major distinct funds which it manages. These funds include MPN, O&MN, OPN, and NAF. These funds can be broken down further but provide enough detail at this level to show the magnitude of possible gains from improved performance. This section presents the aggregate totals managed by NMPC in these funds and then displays the funds allocated to specific functions to portray the size of potential benefits.



## 2. NMPC Funds

The largest fund controlled by NMPC is the MPN fund which is administered by NMPC-7. The MPN fund includes military pay and allowances, retired pay, and permanent change of station monies. These funds are distributed as follows for FY 81.

|                              |                    |
|------------------------------|--------------------|
| Military Pay and Allowances* | \$8,387,000        |
| Military Pay (Reserves)      | \$ 318,000         |
| PCS                          | \$ 577,000         |
| Retired Pay                  | <u>\$8,356,000</u> |
| Total MPN [Ref. 53]          | \$17,638,000       |

The next largest fund administered by NMPC is the O&M account. This money is used to fund such services as, civilian pay, ADP services, temporary additional duty (TAD), and external consulting. The breakdown and totals on O&M spending is as follows:

|                     |                 |
|---------------------|-----------------|
| Civilian Pay*       | \$60,337        |
| ADP Functions       | \$43,082        |
| TAD                 | \$54,623        |
| External Consulting | \$ 7,392        |
| Other               | <u>\$80,721</u> |
| Total               | \$246,154       |

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\*All figures given in thousands.



Some of these monies are separated as strictly reserve funds and some are allocated to active duty requirements.

The next appropriated account is OPN. This is actually a small account since NMPC deals mainly with personnel and their movements rather than procurement. The OPN total is \$8,804\*.

The final account is NAF which are generated from within the DON for welfare and recreation rather than being legally appropriated by Congress. NMPC is the central management control for these funds. NAF funds total \$42,200\* annually.

Although NAF are not part of the DON budget the author includes them with appropriated funds for comparison purposes in order to show the magnitude of funds within NMPC's control. The total of these four accounts is \$17,935,158\* which is equivalent to 36% of the total FY 81 DON budget. If IR was able to improve the economy and efficiency of operation by just one percent it would provide a savings of 179,351\* to the tax payer.

#### H. SUMMARY

This chapter has presented the current structure of NMPC as a starting point for molding an IR function into the organization. In addition to the overall structure of NMPC

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\* All figures given in thousands.



the organizations of the two major financial arms are also presented, the Comptroller and the MPN Financial Management Branch. These branches are presented as possible positions within the existing organization for a new IR Division and also to define their current functions.

The mission and functions of NMPC and its branches are presented to establish common functions that exist throughout the organization. These functions are detailed in Exhibit III-2. These functions are further studied to present those activities which fall under the perview of the DON IR practices.

Finally the budget administered by NMPC is reviewed briefly to present the magnitude of even small gains in efficiency from the utilization of an IR activity.



#### IV. PRESENTATION OF FINDINGS

##### A. INTRODUCTION

This chapter presents the results of the author's research into the internal review (IR) activities of ten personnel entities. The author judgementally selected ten entities that resembled the Naval Military Personnel Command (NMPC) in size and mission. The entities are listed in Exhibit IV-1. The first four activities are all major commercial corporations. The next four are other military services' personnel commands that are equivalent to NMPC. The final two are Civil Service equivalents on the federal and state levels.

The first section explains the research methodology used by the author in conducting the survey. The section also details why the entities in Exhibit IV-1 were selected. It further lays out the areas of interest studied by the author.

The next section presents the results of the survey from each respondent. The final section summarizes the responses in each area and presents a summary table of common internal audit traits.

##### B. RESEARCH METHODOLOGY

The basic research was conducted through individual correspondence with ten personnel activities. The ten



## EXHIBIT IV-1

### SURVEY PARTICIPANTS

1. Texaco Corporation
2. General Electric Company
3. General Motors Corporation
4. Hewlett Packard Corporation
5. H. Q. Army Military Personnel Center
6. H. Q. Air Force Military Personnel Center
7. H. Q. Coast Guard Personnel Branch
8. H. Q. Marine Corps Personnel Branch
9. U. S. Office of Personnel Management
10. California State Personnel Board



entities were selected for various reasons. Nine of the ten were chosen primarily because of their similarity to NMPC in handling the personnel functions of a large activity. The word large as used here refers to numbers of people handled rather than budget responsibility. The tenth is Hewlett Packard Corporation. Although it handles a large number of people it is not comparable with the other nine in terms of total numbers of employees. In phone calls with various corporations the author found that Hewlett Packard is renowned in the business community for its leadership in new ideas in the handling of personnel. The author added Hewlett Packard to the study group to determine if they were significantly different in any respect or if they were experiencing success with any new ideas.

The four military organizations more closely resemble NMPC in terms of a functional description and provided the most accurate comparisons. The three major civilian corporations rank in Fortune Five Hundred's top five for number of employees. Only General Motors is close to NMPC in actual number of employees but all are among the largest non-federal employers. The final two are Civil Service equivalents to NMPC. The Civil Service equivalents do not control the same number of people but their mission is very similar and as non-profit organizations have similar problems, and responsibilities.



A letter was sent to the Comptroller of each of the organizations listed in Exhibit IV-1 requesting background information on their IR activities within their Personnel Branches. The information requested was broad in scope for two reasons; first to preclude inhibiting the respondents, but more importantly because the author was not sure initially what or how much information would be valuable. All the organizations were asked to provide a point of contact for clarification and follow-up.

The author requested information on the following areas with regard to the IR functions of the organization:

1. mission, objectives and policy (personnel department in general for comparison purposes as well as the IR Division)
2. philosophy and scope
3. organization
4. aspects
5. standards
6. characteristics
  - a. technology
  - b. personnel recruiting
  - c. personnel training
  - d. personnel background and qualification
7. budget data (for comparison purposes in specific areas such as TAD, consulting services and ADP)
8. areas of benefit



After receiving initial responses and reviewing the information the author corresponded by telephone to clarify questions and study further the organizations and their procedures.

The author was able to take the results of the theoretical research in Chapters II and II and apply it to the studied entities. The author expanded the areas of study to include the specific aspects, functions and standards that stood out as desirable traits in Chapter III. Each of the survey participants was queried about their approach to those specific traits.

## C. FINDINGS

### 1. Introduction

The findings of the survey are presented entity by entity. The responses from each letter are summarized followed by a description of the entities approach to IR.

### 2. Texaco Corporation

Texaco declined to participate in the survey.

### 3. General Electric Company

The General Electric Company does not have a centralized personnel activity so their response approached the problem two ways. First, IR in the personnel function, second IR for General Electric as a whole. IR for General Electric conforms to internal auditing in the DON.



a. Personnel Function Level Review

Internal Review is required by corporation policy but execution is decentralized. The personnel functions are also decentralized. Each plant or activity within the corporation is delegated the responsibility to set and manage personnel hiring and firing as well as salary structure. Each activity is expected to review their procedures for compliance with generally accepted accounting procedures. Corporation policy demands each plant maximize efficiency and economy.

In order to keep IR within the control of plant executives, General Electric allows each plant to contract internal auditors to conduct IR for all activities within the plant. Contract auditors use Institute of Internal Auditors (IIA) standards. Audits can be conducted on all three aspects of auditing at the discretion of plant managers.

General Electric does not require an audit program or results of reviews to be forwarded to executive management.

For proprietary reasons General Electric would not release budget data.

b. Corporation Level Review

Internal audit is an integral part of General Electric's philosophy. The audit team is small and reports directly to the executive vice president for finance. The



comptroller also works for the vice president for finance. The audit team has two missions, 1. conduct fiduciary audits, and 2. maintain liaison with external auditors.

Audits are conducted in accordance with American Institute of Certified Public Accountant (AICPA) standards. Auditors are rotated through the audit function as part of the financial management apprenticeship program. The auditors are recruited as financial managers and have predominantly Masters of Business Administration (MBA) education backgrounds. The audit department conducts no formal in-house training and relies on on-the-job experience, and graduate education for training.

An annual audit program is submitted to the Financial Vice President in accordance with executive management desires. The primary emphasis is on flexibility and decentralization.

General Electric felt that internal audit provided benefits to the organization through better management control.

#### 4. General Motors Corporation

General Motors Corporation initially considered much of the information the author requested as confidential in nature and was not as specific as other corporations. Follow-up phone calls drew further information from the Comptroller's staff. General Motors maintains a system of IR designed to provide reasonable assurances that its established policies and procedures are carefully followed.



General Motors Corporation relies on IR heavily for fiduciary audits to ensure that records accurately reflect the transactions of the company. Measuring the effectiveness of corporate planning and policy execution is also a responsibility of the IR Division. The Corporation contracts independent CPA's to review their system of controls periodically. The IR Division is also tasked with liaison with independent auditors. The Corporate IR Division conforms to DON internal auditing.

General Motors (GM) has established IR branches at the Corporate level and in each of its divisions. The GM Corporate IR Branch sets general policy guidance for auditing procedures within the divisions. In execution the corporate IR Division concerns itself predominantly with Corporate matters and double checking the procedures of the divisional review branches. The Corporate level conforms to the definition of Internal Audit whereas the division conforms to the definition of IR.

Each Division sets its own policy for personnel matters and the composition of the annual audit program is at the discretion of the chief executive of the division. At the division level the IR staff reports to the Comptroller whereas at the Corporate level the Internal Audit department reports to the Vice President for Finance.

The IR departments are based on generally accepted accounting procedures and as such conform to the standards of the AICPA for the conduct of audits.



GM has a financial management apprenticeship program and recruits personnel for that program from many different disciplines including operations analysts, economists, management, finance and accounting. Individuals are recruited with differing educational degrees; some with masters, some with bachelors and others with professional titles such as Certified Public Accountants (CPA's). GM philosophy is to select the best people from whatever discipline and train them through the apprenticeship program and extensive internal training. Some people also pursue further outside education.

The primary benefit of IR was not identified by the Comptrollers staff but compliance with the Foreign Corrupt Practices Act (FCPA) was pointed out as an important achievement of the function.

#### 5. Hewlett Packard

True to form Hewlett Packard (HP) had a unique system of IR. Corporate philosophy had recently placed a high degree of emphasis on IR but desired that it be executed at the local level. The system at HP is still in its infancy. At the corporate level a five man staff exists to set policy and conduct training. Education is their primary mission. HP desires that each subdivision within the corporation be able to conduct IR, and that it be done with a degree of commonality and professionalism. The staff reports to the Comptroller and is directed by a CPA who relies heavily on AICPA standards in training. The remainder of the staff has



diversified backgrounds. One is an MBA who also has a second masters in systems analysis. A third member is a computer specialist. The fourth member is a CPA. The fifth member has not been hired yet but the director told the author he was looking for someone with a diverse background in financial management; preferably an MBA with auditing background. He added that they are hard to find. The director recruited the other members of the staff directly from university level schools. The program was too new to have a career development established but Mr. Steingard, the director felt that there would be no long term career for the people on his staff but rather they would branch off to other divisions within HP for upward mobility or leave HP to join other corporations.

The IR staff headed by Mr. Steingard is tasked with instructing subdivisions within the corporation on how to evaluate their own systems of internal control. The staff relies on the procedures established in a February 1980 Journal of Accountancy article as a basis for evaluating the sufficiency of an internal control system. This methodology places emphasis on AICPA standards. Currently the HP policy emphasizes the fiduciary and compliance aspects of auditing. This direction stems from the Foreign Corrupt Practices Act (FCPA) which has forced HP to contribute a more formal effort to review and document their systems of internal accounting.



The IR staff is primarily involved in training and is constantly working to further their knowledge and impart that knowledge to the whole corporation. The staff has developed a syllabus for internal training but has not used any external training to date.

The system at HP is too new to have realized any benefits. Mr. Steingard hopes to fulfill his mission by educating the lower echelon management in the necessity of IR not only for better management but to comply with the FCPA.

6. Army Military Personnel Center (MILPERCEN)

MILPERCEN is the first of the military equivalents to NMPC. MILPERCEN administers more people than NMPC but has much less autonomy. MILPERCEN budgets only for in-house requirements. Other budgeting is channeled through the Adjutant Generals Office or the Deputy Chief of Staff for Personnel. Accounting for all travel is accomplished by the Army Reserve Components Personnel and Administration Center in St. Louis. The Comptroller at MILPERCEN is an Army O-6\*.

MILPERCEN is not authorized any manpower for IR. The Comptroller has a management analysis capability but not for conducting audits on a regular basis. Although MILPERCEN

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\* An Army O-6 is a military designation for Colonel.



lacks a formal IR structure, self monitoring and supervisory review are continually performed to ensure compliance. The Comptroller at MILPERCEN referred the author to Army regulations concerning IR.

Army Regulation 11-7 prescribes the role, responsibilities and scope of IR within the Department of the Army (DA). IR is applicable to all commands, installations, activities and agencies of DA.

The Army concept of IR is that commanders will rely on IR capability and appropriate internal controls to ensure the preservation and proper use of resources within their scope of responsibility.

As a general policy IR is to be flexible enough to meet the needs of local commanders. Annual IR programs will be developed based on direction from the commander and staff input.

Auditors shall follow the standards set forth in the Office of Management and Budget (OMB) Circular NO. A-73. These standards established originally by the Government Accounting Office (GAO) will be the basic criteria on which audit coverage and operations are based.

The IR shall report to the Commander of the installation or activity for review and appropriate action.

The Comptroller of the Army (COA) prescribes Army Policy and guidance for the execution of IR. Comptrollers at all levels of command normally are responsible for the



IR function. The IR staff is to be composed of professionally qualified auditors. At the discretion of the local commander, the IR staff may be augmented by military or civilian functional experts. A principal source of training for IR personnel will be from training programs derived and sponsored by the Auditor General of the Army. These programs are intended to provide uniform auditor training and expand individual qualifications.

Since MILPERCEN does not conform to DA regulations concerning IR they could not provide any benefits from its use. When the author asked personnel of the financial management branch at MILPERCEN why they did not have an IR function there was no clear cut answer. Part of the problem is a lack of understanding of the difference between IR and internal audit. The results of all DOD audits must be submitted to Congress semi-annually in accordance with the Inspector General Act of 1978. No one wants to put themselves on report to higher authority so if you do not have an audit to report on you do not have to take the chance of putting yourself on report. IR results do not have to be reported to Congress as internal audits. Further IR should concentrate on different areas than the Auditor General of the Army and thus not duplicate that effort.

7. Air Force Manpower and Personnel Center (AFMPC)

AFMPC is very similar to the MILPERCEN in mission and autonomy. They report to a Deputy Chief of Staff for



Personnel and manage funds for the operation of the Personnel Center only rather than the entire Military Personnel Air Force (MPAF) account. There is no IR function at AFMPC and the current Comptroller an Air Force O-3\* prefers it that way.

The Department of the Air Force (DAF) unlike the other services has a very centralized IR program. The DAF does not assign IR personnel to local commanders. Instead the Air Force Audit Agency (AFAA) dedicates up to 15% of direct audit time to the special audit requirements of local commanders.

The Assistant Secretary of the Air Force for Financial Management provides technical guidance and supervision on audit policies and management matters.

The DAF view of IR is very centralized. Local commanders must rely on the limited capabilities of the AFAA to meet their needs for internal evaluation. The centralized audit agency restricts the time that they allocate to IR as well as the scope of topics that they will consider. The structure is very formal and inflexible. When the AFAA does conduct an IR it does so at the behest of the local commander. However, local commanders have criticized the external nature of the agency and expressed a reluctance to use it [Ref. 54].

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\*The Air Force O-3 is the designation for an Air Force Captain.



Another criticism of the AFAA is the lack of knowledge of the auditors. DAF managers feel that IR personnel should not be all generalists like the AFAA employs.

The AFAA uses GAO standards for guidelines in conducting its audits. The AFAA staff is comprised predominantly of accountants who specialize in auditing. The AFAA is capable of conducting all three aspects of auditing but has been chastized by GAO for not performing enough economy, efficiency, and effectiveness audits.

#### 8. Coast Guard Personnel Branch

The Coast Guard is contained within the Department of Transportation (DOT) and is thus not required to conform to the same DOD policy directives concerning IR as the other services. The Coast Guard is an extremely compact organization with a small number of people.

The Coast Guard does not employ IR but considers internal control a normal management function [Ref. 55]. All control audit functions are performed by the DOT Inspector General Staff. The DOT Inspector General must report all findings to Congress semi-annually. The legal requirement to report audit results precludes the DOT Inspector General (IG) from being responsive to the confidential desires of the local commanders.

The centralized nature of the IG and the preoccupation with financial compliance audits limits the capability of the IG.



DOT auditors are varied in background but are for the most part accountants with experience in pay, travel and household goods. Other than prior experience and training, the Coast Guard relies on training received through experience on the job.

The IG staff does not use an annual audit program but instead relies on local needs. Central audit procedures are prescribed in Coast Guard instructions. These procedures address only financial audits. The Coast Guard makes no distinction between internal audit and IR.

#### 9. Marine Corps

The Marine Corps Personnel Branch did not respond to the author's letter request for information on their IR activities. Follow-up inquiries by the author with the Marine Corps Headquarters Branch responsible for IR policy provided further information. The IR office of the Fiscal Director of the Marine Corps knew of no function within the Personnel Branch.

The Marine Corps in the author's opinion has the best written policy for IR of all the Armed Services. The Marine Corps IR function is designed to provide commanders an organic capability to examine, analyze, evaluate, and explore those areas of operations where known or potential problem areas exist [Ref. 56]. Central Policy for IR as set by the Fiscal Director of the Marine Corps requires all commanders to establish and maintain an IR function. The IR staff is to



be organizationally located as part of the comptroller's office but should be ensured objectivity and independence. The local IR staff prepares an annual review program prior to the beginning of each fiscal year. The program is to be developed using inputs from the local Commander's staff, urgent items highlighted in external audits, and projects which remain incomplete from the previous year. A copy of the annual review program is submitted to the Fiscal Director of the Marine Corps. The program reserves time for high priority items that come up during the year.

The IR staff evaluates all three aspects of audits; fiduciary, efficiency and effectiveness.

The Marine Corps policy on IR establishes a derivative set of standards for the conduct of reviews. The standards are very similar to GAO standards.

The IR staff is a composite of disciplines sufficient to fulfill the requirements of the commands involved. Most commands utilize accountants and analysts as the basis of their IR staffs. These personnel are augmented by specialists as required in specific areas.

Local commands are responsible for recruiting and hiring the mix of personnel they desire. The IR staff does not have a career development plan for its auditors. New members of the IR staff are trained by other members of the staff.



The main benefit of IR is prompt detection of troublesome and unsatisfactory conditions.

10. United States Office of Personnel Management (OPM)

The OPM develops internal personnel policy and provides operating personnel service in such areas as staffing, position classification, career development, labor management and employees relations for government workers. The mission of OPM is very similar to that of NMPC. OPM employs fewer personnel than NMPC and handles a much smaller budget but is actually organized very similar. One exception is that OPM has many regional offices.

The IR function for OPM is conducted by the Program Management and Evaluation Branch. The IR branch reports to the Chief of the Personnel Policy and Information Division, a GS-15.

The Program Management and Evaluation Branch is responsible for evaluating OPM's personnel management program in the central and regional offices. The Evaluation Branch also provides staff level advice to operating personnel specialists and line managers. The IR branch evaluates OPM programs to assure compliance with law, regulation, and agency policy.

The Program Management and Evaluation Branch sets and executes the central policy for IR within OPM. Since OPM is much smaller than its service equivalents it has centralized the execution of IR. The Program Evaluation



staff generally travels about three times a year to regional offices. Evaluation teams consist of three members. Since the OPM Evaluation staff conducts all reviews it conforms more to the definition of internal audit for the regional offices.

Evaluations are grouped into two aspects of reviews: compliance and effectiveness. In the first type of evaluation the review team looks for compliance with law, regulations and management practices. In the latter evaluation, progress, impact and effects of activities are measured.

The evaluation personnel are comprised of personnel management specialists at the GS-13 and GS-14 level. These personnel specialists have degrees in business administration and public administration with several years experience in operating personnel offices. The members of the staff have a career in the civil service as personnel specialists and were recruited from operating personnel offices and from other external evaluating entities within the Federal Government. In the view of the Chief of the Program Evaluation Division, their next career move would be outside of the area of IR.

Their largest gain is finding useful recommendations for change within the OPM organization.

#### 11. State Personnel Board (California)

The State Personnel Board (SPB) is responsible for the administration of the state civil service and affirmative



action programs. It is the state of California equivalent of OPM for the federal government. It has similar responsibilities to those of NMPC for promotion, classification and equal opportunity for employees. SPB is smaller than NMPC or even OPM but performs many of the same functions.

SPB feels it is too small to have its own staff or internal auditors. They have two internal groups at SPB that perform reviews and one external group at the State Controllers Office that is called on for audits. The external group is responsible for financial and compliance audits. The Audit, Control, and Information Practices Division within SPB endeavors to improve and assure compliance with State programs and policies regarding the selection and qualification of employees. The Budget and Management Analysis Unit is tasked with assuring the proper expenditure of state funds.

The SPB does not have a stated policy on IR nor do they acknowledge the difference between internal audit and IR. However, the actual performance of fiduciary reviews by the Budget and Management Analysis Unit and efficiency and effectiveness audits conducted by the Audit, Control and Information Practices Division are in the author's opinion defacto IR. The financial and compliance audits done by the State Controller function as internal audits similar to Naval Audit Service (NAS) continual reviews of NMPC procedures, and as such conform to internal auditing.



The SPB does not use an annual audit program nor do they coordinate the activities of their two review divisions. They keep the financial and personnel audits separated. The actual schedule of audits is very flexible and is open to requests or input from executives within the state.

The SPB does not require the use of specific standards for the conduct of their audits, but does require that auditors be familiar with GAO standards. The auditors in the Budget and Management Analysis Unit are all accountants and those in the Audit, Control and Information Practices Division are personnel specialists. Supervisors on both sides are required to have significant affirmative action and management experience and background.

The state has an inservice training center for training in various accounting systems.

Auditors in both personnel and financial matters report to line managers rather than the Comptroller or other higher executive. Career development for auditors is within the state accounting personnel fields and is not limited to auditing. Auditors are recruited from college or other business schools as accountants rather than auditors.

#### D. SUMMARY

The responses to the author's research provided some clear cut areas of agreement between the respondents. In the author's view this agreement especially in the profit world of the



corporations clearly highlights these characteristics as desirable.

The table in Exhibit IV-2 summarizes the response to the author's letters.

All respondents agreed on two areas, which were; the desirability of a flexible audit program and, the necessity for in-house training. Flexibility in the author's opinion, is the reason for a lack of total consistency. Each program is tailored to the desires and needs of the organization. This tailoring caused the lack of conformity. It is interesting to separate the responses into three categories: 1. Armed Forces, 2. Corporations, and 3. Civil Service Equivalents. This separation creates more consistency within the groups but does not create total agreement.

This indicates in the author's opinion that the more similar the organization the closer IR Divisions will conform. The general consensus from the survey is that the executive staff should set a central policy for IR that can be executed locally. There should also be an internal audit function separate from this local IR. The local activity and the internal audit function alike should have annual audit programs detailing what they plan to accomplish during the year. This plan should involve local staff and executive input and should be flexible enough to handle urgent matters that may come up during the year.



## EXHIBIT IV-2

## SURVEY RESPONSE SUMMARY

|                         | Air<br>Force      | Army               | Coast<br>Guard | Marine<br>Corps | GM              | Tex-<br>aco | GE    | Hewlett<br>Packard | SPB | OPM |
|-------------------------|-------------------|--------------------|----------------|-----------------|-----------------|-------------|-------|--------------------|-----|-----|
| CENTRAL POLICY          | Y                 | Y                  | Y              | Y               | Y               |             | Y     | Y                  | N   | Y   |
| DECENTRALIZED EXECUTION | N                 | N                  | Y              | Y               | Y               |             | Y     | Y                  | Y   | N   |
| SEPARATE IR/IA          | N                 | Y                  | N              | Y               | Y               |             | Y     | Y                  | Y   | N   |
| ANNUAL PROGRAM          | Y                 | Y                  | N              | Y               | Y               |             | N     | Y                  | N   | Y   |
| EXECUTIVE INPUT         | Y                 | Y                  | Y              | N               | Y               |             | Y     | Y                  | Y   | N   |
| FLEXIBLE                | Y                 | Y                  | Y              | Y               | Y               |             | Y     | Y                  | Y   | Y   |
| FIDUCIARY               | Y                 | Y                  | Y              | Y               | Y               |             | Y     | N                  | Y   | Y   |
| EFFICIENCY              | Y                 | Y                  | N              | Y               | Y               |             | Y     | Y                  | Y   | N   |
| EFFECTIVENESS           | Y                 | Y                  | N              | Y               | Y               |             | Y     | Y                  | Y   | Y   |
| STANDARDS               | GAO               | GAO                | NA             | D               | AICPA           |             | AICPA | AICPA              | NA  | NA  |
| INTERNAL TRAINING       | Y                 | Y                  | Y              | Y               | Y               |             | Y     | Y                  | Y   | Y   |
| EXTERNAL TRAINING       | NA                | Y                  | NA             | NA              | O               |             | N     | N                  | NA  | NA  |
| ACCOUNTANTS             | Y                 | Y                  | Y              | NA              | Y               |             | Y     | Y                  | Y   | N   |
| ANALYSTS                | N                 | O                  | N              | NA              | Y               |             | N     | Y                  | N   | Y   |
| REPORT TO               | N                 | C                  | C              | CE              | B               |             | CE    | CE                 | LM  | LM  |
| EDP AUDITS              | NA                | Y                  | NA             | NA              | Y               |             | NA    | Y                  | NA  | NA  |
| RECRUIT AUDITOR         | N                 | NA                 |                | NA              | Y               |             | Y     | Y                  | N   | N   |
| CAREER DEVELOPMENT      | N                 | F                  | NA             | NA              | F               |             | F     | B                  | F   | P   |
| WITHIN IA               | N                 |                    | NA             | NA              |                 |             |       |                    |     | Y   |
| WITHIN FIN.             | N                 | Y                  | NA             | NA              | Y               |             | Y     |                    | Y   | N   |
| Y-Yes                   | C-Comptroller     | D-Derivation       |                |                 | LM-Line Manager |             |       |                    |     |     |
| N-None                  | NA-Not Addressed  | CE-Chief Executive |                |                 | L-Limited       |             |       |                    |     |     |
| O-Optional              | F-Financial Field | B-Both             |                |                 | P-Personnel     |             |       |                    |     |     |



The IR staff should be capable of handling all three aspects of auditing. The respondents almost all agreed that standards should be invoked but disagreed on which standards. This is understandable with the civilian corporations leaning towards the AICPA standards and the government entities using GAO standards or a derivative of GAO standards.

In-house training of auditors on local procedures and updated audit techniques is a must. External training was not addressed or not utilized by most respondents.

The vast majority of people involved with IR are accountants but many use personnel specialists, analysts or system specialists on a permanent or as required basis. Calling upon specialists to augment the normal staff compliment was a popular practice. In the DAF where it is not done it was cited as a criticism of the review system.

The respondents were almost evenly split on whether they recruit personnel especially as auditors or for other reasons. This goes hand in hand with whether they will be part of a career development program or whether the auditing job is the sole purpose of their employment. Most of the respondents did consider the auditors as part of an apprenticeship program for career development in financial management.

The author has saved the area of EDP audits for last because of the lack of firm information. Most respondents acknowledged that they did EDP audits but were reluctant to



discuss them because of confidentiality or the technical nature of the subject.

The findings of the author's survey point out characteristics that will be utilized in the next chapter in the presentation of the model for NMPC IR.



## V. ANALYSIS OF THE MODEL

### A. INTRODUCTION

The Model presented in this chapter will be a composite of the earlier presented research into the operations of Personnel Activities similar to the Navy Military Personnel Command (NMPC), and theoretical data accumulated through literature searches as presented in Chapters II and III.

The first section presents background information on different types of models and their uses. The author then defines the model chosen for this thesis and explains its application to NMPC and internal review (IR).

The author next presents the model proposed for NMPC explaining its derivation and applicability to NMPC.

The author's model starts with policy guidance for an IR entity. The policy guidance leads to a definition of the IR mission and its functions. The policy statement also mentions standards which are then established by the author for the execution of a professional audit. The next section enters the area of scope including aspects, workload and planning. The organizational structure of the model both internal to the IR Division and within NMPC is then presented.

The final section deals with characteristics of the organization including technology, personnel, and training.



## B. GENERAL DEFINITION OF MODELS

Webster defines model as a standard for imitation [Ref. 57]. The author's model will be a standard designed for imitation by NMPC. The author wishes to emphasize that the model as presented in the definition is a standard, or guide not a hard and fast rule. There are many types of models in use to analyze and understand complicated situations. People think of computers or mathematics when the word model is mentioned; when in fact, many of the models in use are non-mathematical, but conceptual or descriptive.

A conceptual model is used to predict organizational and individual behavior and to analyze events and actions [Ref. 58]. This can be depicted by a revenue-tax budget for the federal government, where revenues will be related to the level at which taxes are set. A descriptive model is a simplified representation of reality [Ref. 59]. This can be visualized by a line diagram describing the organization of an activity.

The use of a model, whether, conceptual, mathematical or descriptive takes into account the principal forces and events acting in a specific time frame, which affect a current phenomenon [Ref. 60].

The author's model for IR is a descriptive model. It establishes an organization to explain what should go on at NMPC. The organization provides a basis to help the managers achieve their goals and objectives by providing a



framework for measuring performance and analyzing future events based on current actions. The model is a descriptive conceptualization of practical and theoretical guidelines for establishment of an IR Division at NMPC.

### C. POLICY

The first step in establishing a model for an IR Division is to set some broad policy guidelines. The majority of respondents to the survey addressed in Chapter IV felt that the policy statement should address the mission, standards, scope and organization of the IR Division. The broad NMPC policy should be within the framework of Department of Defense (DOD) and Department of the Navy (DON) policy. The policy must be tailored to the requirements of NMPC.

Both DOD and DON IR policy are currently being evaluated and revitalized. The new DOD office of Review and Oversight is examining its current stance on IR and is looking towards taking a more aggressive enforcement role. The DON has recently hired an experienced internal auditor to coordinate a central policy for IR in the DON [Ref. 61].

Current DON policy on IR is set forth in Secretary of the Navy Instruction (SECNAVINST) 7510.8 entitled "Internal Review in the Department of the Navy." It requires decentralized IR within the DON and places the responsibility for its performance on the local command. The current instruction addresses mission and scope. The Auditor General



of the Navy, according to the instruction, will address the technical guidance required for compliance with the directive. The Auditor General has since published a self instructional learning unit on DON Audit and IR.

The learning unit describes a set of derivative General Accounting Office (GAO) standards for the conduct of an audit and presents some general organizational policy.

The policy provided in these two instructions addresses the pertinent points entailed in responses from the author's survey. The learning unit in the author's opinion contributes however, to the misconception that internal audit and IR are one and the same. The author contends that separate learning units should be published for each function.

NMPC should create their own policy based on these directives. NMPC policy guidance should be more specific than these directives and should clearly address what functions are entailed in the mission of the IR Division; what standards they are expected to follow; what defines their organization; and what is the scope of their responsibilities. These attributes were mentioned by respondents as pertinent traits of their policy statements. In the author's survey eight of the nine respondents had a central policy set by the executive staff. Six of nine of these policies called for decentralized execution. The difference between internal auditing and IR was recognized in six of the nine respondents. The policies required an annual program in six instances and



in seven responses called for local executive input to the review program. All nine respondents desired an IR program that was flexible enough to cover different topics and meet surging requirements.

In summary NMPC should work with the new Navy Comptroller's (NAVCOMPT) Office of Internal Review discussed in Chapter II to structure a specific policy for the execution of IR at NMPC. The policy should require an annual program involving input from various members of the staff and should be approved by the Commander NMPC each year. The policy should define the mission, scope, and organization. The technical guidance on standards, characteristics, and execution should also be established in the NMPC policy directive. Finally the directive on IR should define the difference between IR and Internal Auditing (IA) and explain that IR is the responsibility of the local commander while IA is the responsibility of Naval Audit Service (NAS).

#### D. MISSION

There is a very fine line drawn between mission and scope. Mission conforms to the definition or objectives of IR and scope pertains to those areas in which NMPC desires to apply IR.

The mission of IR at NMPC should be the execution of special audits, studies, and analysis to detect deficiencies, improprieties, and inefficiencies and to provide recommendations in order to correct conditions that affect the overall



mission or integrity of the command. This mission should involve the examining of management controls, practices and procedures at all levels to determine adequacy in concept and effectiveness in application [Ref. 62].

Survey respondents listed several specific activities that were in the pervue of their IR Divisions and in two cases commented that their IR personnel were responsible for conducting any study requested of them. In both of these cases the respondents later commented that the IR Division was comprised of too many generalists and not enough specialists. This led the author to the opinion that NMPC should specify a bank of functions which would be within the capability of the IR Division to accomplish. By establishing these functions the IR Division could ensure they recruit the proper personnel to conduct the audits in a professional manner. Exhibit V-1 presents a list of functions that the author contends should comprise NMPC's bank. The list was generated from the Auditor General's training syllabus on IR and research information presented in Chapters II, III and IV. The respondents in Chapter IV had several functions that they considered valuable in their IR Divisions, and NMPC had many common functions in existence that presented fertile areas for application of IR. These areas have also been included in Exhibit V-1.

Exhibit V-2 lists specific applications of IR as they could be applied at NMPC. The conduct of these functions



## EXHIBIT V-1

### FUNCTIONS OF NMPC INTERNAL REVIEW MODEL

1. Maintain liaison with auditors of the NAS assigned to perform continuous, periodic, or other audits: providing similar liaison where appropriate to other audit or inspector representatives such as GAO, Inspector General or Command Inspection.
2. Monitor the correction of deficiencies which are revealed by NAS, GAO, or by other external inspectors.
3. Conduct analysis, studies or investigations into organization effectiveness, efficiency or other problem areas as directed in both personnel and financial areas.
4. Monitor and critique the design and installation of financial and accounting systems and procedures, with emphasis upon the identification and use of valid audit trails and other management controls.
5. Monitor personnel and financial programs, procedures and controls.
6. Advise on matters of organization and staffing within NMPC.
7. Auditing civilian timekeeping and payroll functions and non-appropriated fund activities.
8. Designing and applying audit checklists for IR of areas that are considered unique or critical to NMPC in the safeguarding of resources; for example, the areas of  
a) ADP services and security, b) prevention and detection of theft and fraud involving government resources, and  
c) effective use of consulting services.
9. Providing advice and reviewing the use of quality control and other indicators that routinely gauge the effectiveness of personnel and financial management.
10. At random occasions, review the proper execution of directed programs such as; a) cost reduction, b) financial reports, and c) reconciliation.



## EXHIBIT V-2

### SPECIFIC APPLICATIONS OF NMPC IR FUNCTIONS\*

1. During Biannual Command Inspections the IR Division would be charged with providing support services such as office space. The IR Division would also establish an inspection schedule and provide points of contact for the inspection team.
2. If the resident NAS team discovers an inefficient practice at NMPC it would be the responsibility of the IR Division to follow-up and ensure that the inefficient practice is corrected.
3. Conduct a study on the reasons for delays in issuing orders and recommend corrective action.
4. When the Comptroller installs a new accounting system the IR Division would monitor the design and installation to insure the new system would provide an adequate audit trail.
5. The IR Division should monitor the execution of personnel programs ensuring compliance with established policy.
6. Periodically review the effectiveness of the NMPC organization and make recommendations for changes as necessary.
7. Select divisions within NMPC at random and audit their civilian timekeeping procedures to ensure compliance with established policy.
8. Periodically audit the use of external consultants and the administration of contracts.
9. Review the Permanent Change of Station budgeting procedures to gauge the effectiveness of existing practices.
10. Review and study the effects of detailers at NMPC. Would more detailers have a positive influence on retention?

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\* Each of the examples pertains to the same numbered function presented in Exhibit V-1.



will provide the commander with an evaluation of the services the NMPC organization is providing. They will further assure the Commander that members of his or her organization are executing their responsibilities in an effective and efficient manner.

#### E. STANDARDS

The standards for the NMPC IR Division should be based on the standards provided by the Navy Auditor General in the previously mentioned training syllabus. The Navy Auditor General standards are provided for the reader's benefit in Appendix A.

These standards are based on the GAO standards and are in the author's opinion sufficient for the professional conduct of an IR.

The NMPC IR Division should modify or add to these standards as necessary to cover all situations required by the IR mission statement. These standards should be specified in the NMPC policy guidance on IR.

#### F. SCOPE

IR is to be conducted by members of the NMPC staff who are familiar with executive operating policy and local operating procedures. The reviewers are primarily fact finders for the commander. Activities should include all three aspects of auditing as presented in Chapter II. The reviewers should direct their activities towards uneconomical,



inefficient or ineffective use of resources or noncompliance with directives or established internal control procedures.

The internal reviewer should be concerned with recommending appropriate action to correct deficiencies as well as finding the problems. The reviewers should apply their resources to the functions listed in Exhibit V-1. The Commander NMPC should reserve a portion of the IR time for special projects he or she may wish undertaken. The remainder of the IR time should be determined annually by inputs from NMPC department heads and the director of the IR Division. This approach will ensure independence for the IR Division and yet provide coverage of topics important to the individual department heads.

The distribution of review time will be published as the annual IR Program. When insufficient time is available to review all requested areas the Commander NMPC should set priorities by which topics are to be reviewed.

The review program should be compared with audit programs of other agencies such as the resident audit team from NAS to ensure there is no duplication of effort.

In Chapter II it was determined that the average DON report required 25-35 review days to complete. For workload planning NMPC should anticipate 35 review days per topic and establish a nominal number of work days per year. For purposes of discussion the author considered that there were 250 work days annually. This number is based on 52 weeks at



five days per week minus the ten additional federal holidays. This means each reviewer can accomplish about seven reports per year. The size of the workload should determine the size of the work force but because of the large organization and budget the author believes a minimum of ten people should initially be assigned to the IR Division. These ten people will enable the division to accomplish approximately 70 reports a year. This number of people should be adjusted in accordance with the changing needs of NMPC.

#### G. ORGANIZATION

The organization of the IR Division can be approached from two directions. The internal organization established by the IR Division itself and secondly where the division sets within NMPC.

##### 1. Internal Organization

The survey respondents provided no consensus for the internal organization of the IR Division. The majority of respondents did use a team concept where auditors would be brought together for a specific purpose based upon the skills required for the audit project. Seven of nine respondents felt the auditors should be from different disciplines to take advantage of their expertise. The respondents were unanimous in supporting the independence of the auditors and the importance that their findings gain command support.



The director of the organization should be a person who has sufficient seniority that he or she will both provide clout for the IR Division and depict the importance of the entity within NMPC. The author feels that a GS-14 with audit experience would provide the stability and seniority required. In the author's opinion based on discussions with OPM, qualified personnel below the GS-14 level are transient as they search for upward mobility. A GS-14 position would be relatively stable and would possess the seniority to demand respect for IR findings.

Author discussions with NMPC personnel in various divisions revealed a resistance to IR. For this reason the author recommends the initial IR Division organization be small to reduce the bureaucratic resistance to large scale change.

Below the Director there should be two major subdivisions, one for financial matters and one for personnel matters. Each of these subdivisions would be responsible for all three levels of auditing (i.e. economy, compliance and effectiveness) in their respective areas. The subdivisions would be created in order to build a base for expertise and professionalism. Respondents to the author's survey pointed out the value of auditors being familiar with the audit topic and having more than a general knowledge of the topic. These subdivisions do not need to be equal in size. In the author's opinion the financial subdivision



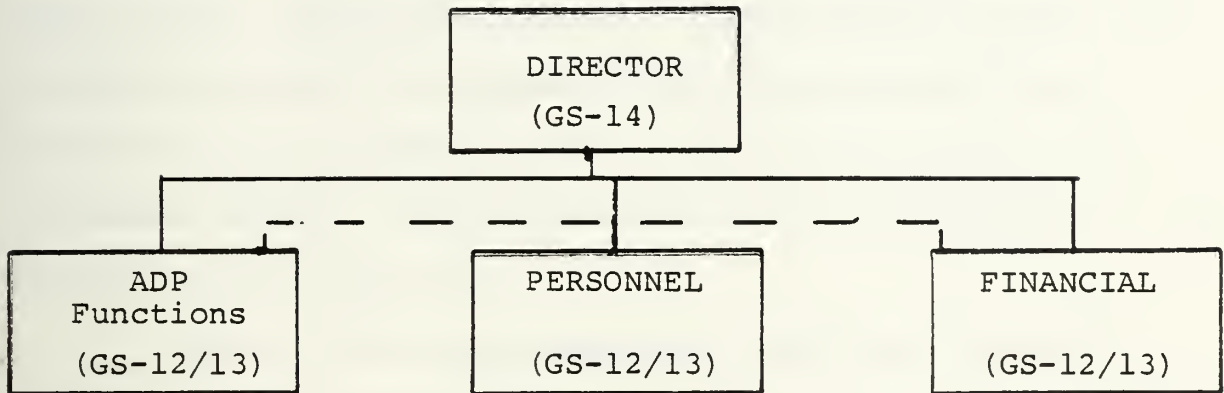
should initially be larger because of the size of the NMPC budget and the potential for savings in the financial area. These decisions should ultimately lie with the Commander NMPC since the division should be structured to provide him or her with support in the areas desired. A third subdivision that could be formed would be ADP. The ADP functional area provides a great deal of support to the operation of NMPC. It is a very specialized area and requires people who possess the technical knowledge to conduct a professional audit of its operation and recommend solutions to observed problems.

When an audit project is undertaken by the IR Division, one of the subdivisions should be selected as the lead or responsible division. The lead division should conduct a preliminary survey and determine the needs of the specific audit team. The members of the audit team should then be selected from the available talent within the existing subdivisions of the IR Division. For example, if the personnel subdivision was selected as lead on a project to review the management of the Permanent Change of Station (PCS) Program it might require the services of an accountant from the financial subdivision to audit the management of funds, a personnel specialist to review the career management implications and an ADP expert to investigate the issuing of PCS orders.

Exhibit V-3 provides a line diagram of the author's proposed internal organization.



EXHIBIT V-3  
IR DIVISION ORGANIZATION





## 2. External Organization

The author's research presented no clear cut answer to where the IR Division should be placed within the NMPC organization. There was not a wide variance of answers. Two choices repeatedly appeared. Respondents felt that the IR Division should be placed either in the Comptroller's organization or directly under the chief executive or the principal deputy. Library research was equally split between the two locations.

Three of the nine respondents had the IR Division report directly to the chief executive of the entity. Two others had the IR Division report to a line manager other than the Comptroller and one respondent had the IR Division report to both the chief executive and the Comptroller. The two remaining respondents had the IR Division report to the Comptroller.

In Chapter II it was pointed out that the current DON practice calls for the IR Division to report directly to the unit Commanding Officer. Library research of current professional journals emphasized the importance of the IR Division's independence. The Institute of Internal Auditors (IIA) states independence is one of the primary standards for the professional internal auditor [Ref. 63]. Independence is necessary for objectivity. The IIA declares that the IR Division must be placed organizationally such that it will be able to accomplish its audit responsibilities [Ref. 64].



In the author's opinion since the IR Division would be conducting studies and audits of all the departments within NMPC including the Comptroller it must not be placed under the control of any department. The IR Division should be placed in a staff position reporting to the Chief of Staff for NMPC. The Director of the new IR Division should be tasked with briefing the results of all audit projects to the Chief of Staff and submitting all reports to the Commander NMPC.

Exhibit V-4 depicts the author's proposed staff placement of the IR Division.

## H. CHARACTERISTICS

This section is important because it stresses the importance of the proper infusion of motivated and trained people in achieving the desired success. The author addresses the characteristics of the IR Division from a personnel standpoint. This section presents the kind of people that should makeup the IR Division, where they can be recruited, and what general qualifications and specialized skills they should possess.

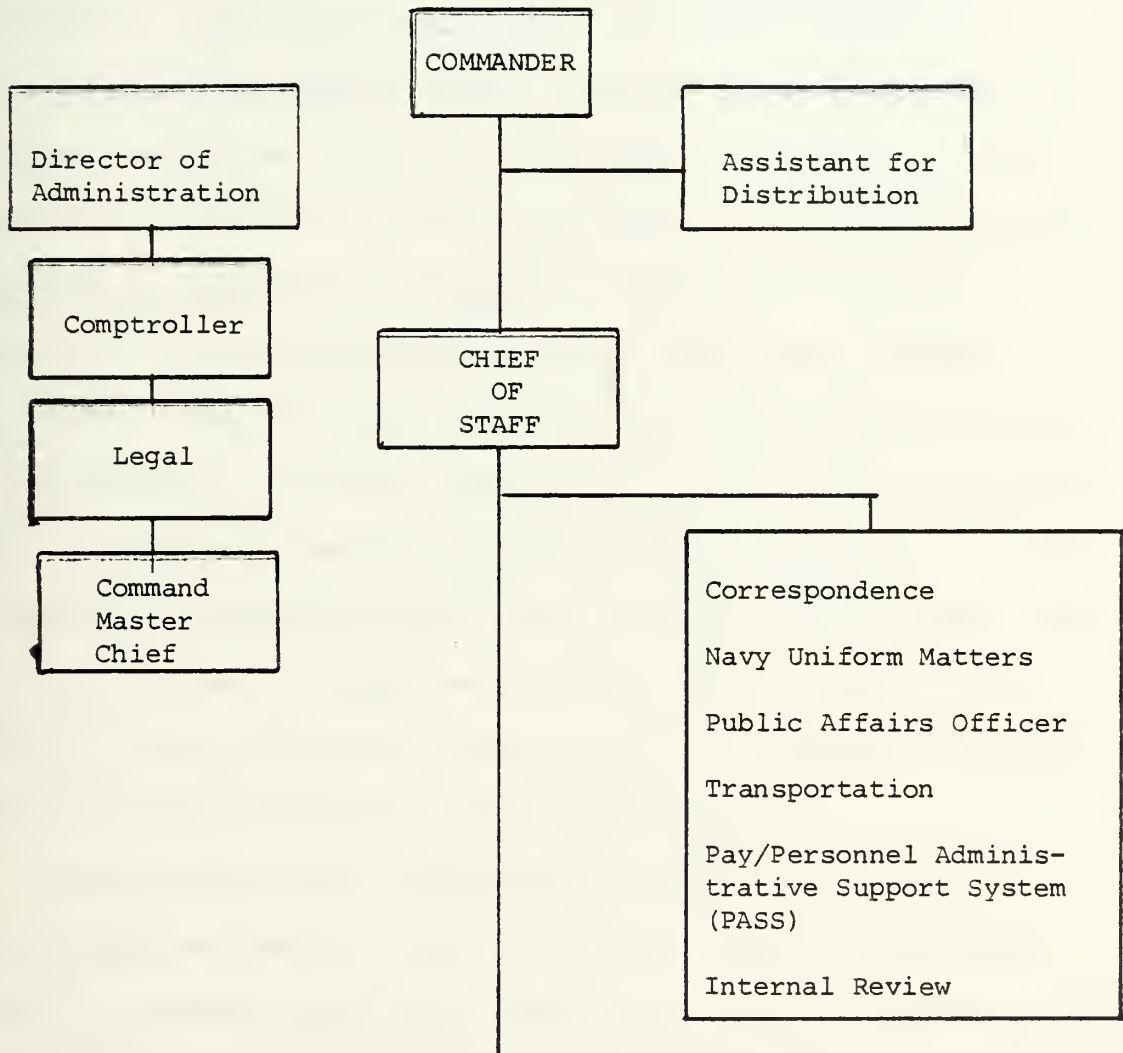
### 1. Personnel

In order to perform financial and compliance, economy and efficiency and program results audits the IR Division needs more than just accounting and auditing disciplines [REF. 65]. For this reason, the author has selected three primary groups of personnel that should be represented in



EXHIBIT V-4

NMPC STAFF ORGANIZATION  
WITH AN  
INTERNAL REVIEW DIVISION



REMAINDER NMPC



the IR Division: management analysts, program analysts and auditors. Respondents to the author's survey supported this concept. Only the Air Forces uses predominantly auditors and accountants. The other respondents employed analysts, auditors and other specialists to ensure that the reviewers have the requisite knowledge required for the audit project.

Within the three primary groups, the experience and background should be further subdivided to match the organizational subdivisions of the IR Division. The author believes the financial subdivision should be comprised of auditors, accountants, accounting personnel and accounting systems specialists. The personnel subdivision should employ management specialists. The ADP subdivision should have management analysts, computer specialists and program analysts. Exhibit V-5 depicts a sample staffing chart for the IR Division. As the division grows in importance and scope it could add an economist to the financial subdivision or a manpower development specialist to the personnel subdivision.\*

Nine of the ten respondents agreed that the internal auditors must be familiar with the topic they are reviewing. In order to achieve this goal NMPC must recruit personnel for the IR Division that will fulfill the requirement. In the

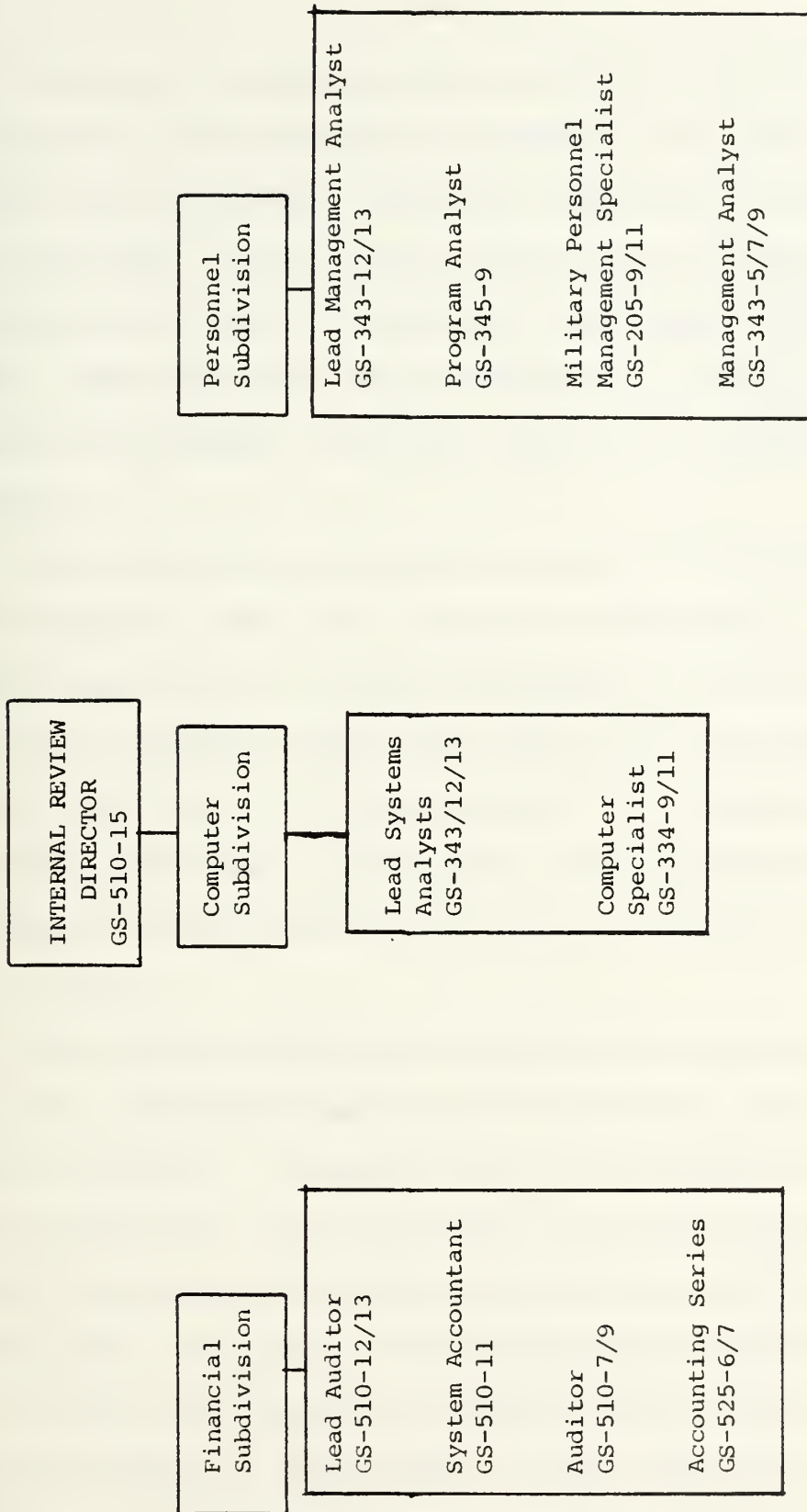
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\*All the job titles used by the author are selected from the Office of Personnel Management (OPM) Handbook on job standards.



# EXHIBIT V-5

## INTERNAL REVIEW STAFFING CHART





author's opinion, job descriptions should be tailored to meet the experience and background requirements that will provide the proper mix of people. Since all employees of NMPC will be civil servants, their general description of work can be selected from the Office of Personnel Management (OPM) handbook. NMPC can write the job description to provide for experience in personnel, auditing, NMPC, or a combination of all three.

Recruitment is an important phase in the development of an IR function [Ref. 66]. Using the tailored job descriptions and high position rating the Director of the IR Division can attract qualified people from other audit entities and personnel activities. On the personnel side emphasis should be placed on experience within NMPC. This experience will add credence to the auditor's findings and shorten their learning curve.

The initial complement of people should be acquired by absorbing functions that exist at NMPC under the pervuew of other divisions. In Exhibit III-2, it was pointed out that the Comptroller was responsible for the review of civilian timekeeping and payroll and liaison with external audit agencies. By assuming these responsibilities the IR Division should also assume the billets that go along with the accomplishment of these tasks. Since some new tasks are to be taken on, some new billets would also have to be justified and approved.



Survey respondents used their auditors for only a short time (2-3 years) as they were part of a career development program. Career development programs in civilian corporations moved personnel to different apprenticeship fields such as budgeting, auditing, accounting, strategic plans and comptrollers office. These movements were made at the discretion of executive personnel based on the capabilities of personnel within the program. Limitations in the civil service program prevent NMPC from providing the same career progression that a private firm offers. However, the individual can pursue that same development if he or she desires, as job openings become available.

In order to create the openings and enhance the opportunities for career progression, NMPC should establish a good mix of positions in the IR Division. In the author's opinion, this mixture of position ratings will entice qualified people seeking advancement through these positions. Further, by adding active duty Naval Officer positions within the audit organization NMPC can control the recruitment of subspecialists in selected areas of finance, personnel, computers and analysis. The use of Naval Officers in the IR Division will also smooth liaison with other NMPC Divisions comprised primarily of Naval Officers.

Turnover at the lower and middle echelons was desirable in the eyes of the survey respondents as it gave them new views and kept the auditors from becoming entrenched in



their ways or familiar with the people they were auditing. Military transfers and motivated civil servants striving for upward mobility would create the desired turnover.

## 2. Training

The author's survey showed two key issues about IR training. First, most IR Divisions do significant in-house or on the job training. Second, very little outside sponsored official training is utilized.

All nine of the survey respondents conducted internal training either on the job or through classroom lectures. On the job training was of the intern nature. New personnel would be assigned to a more experienced person for an apprenticeship period prior to striking out on their own audit project. Classroom training was conducted to appraise all members of the organization about new rules or regulations or other matters of wide acceptance.

With regard to external training, only one respondent, the Army, confirmed its use. Other respondents felt it was not applicable, not available or was at the discretion of employees to pursue further education.

Furthering the education of employees in the author's opinion would be a benefit to the organization and would therefore be applicable. Whether the cost merits the benefit is a question that each organization would have to address. The external education is available since the Army does take advantage of it. The Internal Auditor lists training courses



and seminars that are offered to benefit the internal auditor. Additionally, the Inter Agency Audit School and NAVCOMPT offer entry level and mid career courses throughout the year in auditing and IR.

The author concurs with the respondents that extensive use of internal training is beneficial for developing and maintaining professionalism. The author does not agree that external training is not applicable. Outside training courses should be utilized to further professionalism and maintain the IR Division's capabilities with the state of the art. The external training does not need to be extensive and lessons learned can be returned and imparted via internal training to those who did not attend.

### 3. Technology

The author experienced only minimal success in getting survey respondents to talk about the use of modern technology in auditing. In questions on computer audits or audits of computers, six of the respondents would do nothing more than acknowledge that it was done in some areas. Three other respondents acknowledged that it was gaining in importance and that they were working on new methods. But even these respondents refused to expound on techniques or areas where it was employed. The author believes that EDP/ADP auditing in today's automated world is complicated and that an IR Division must possess the highly technical skills to understand and accomplish audits of these areas.

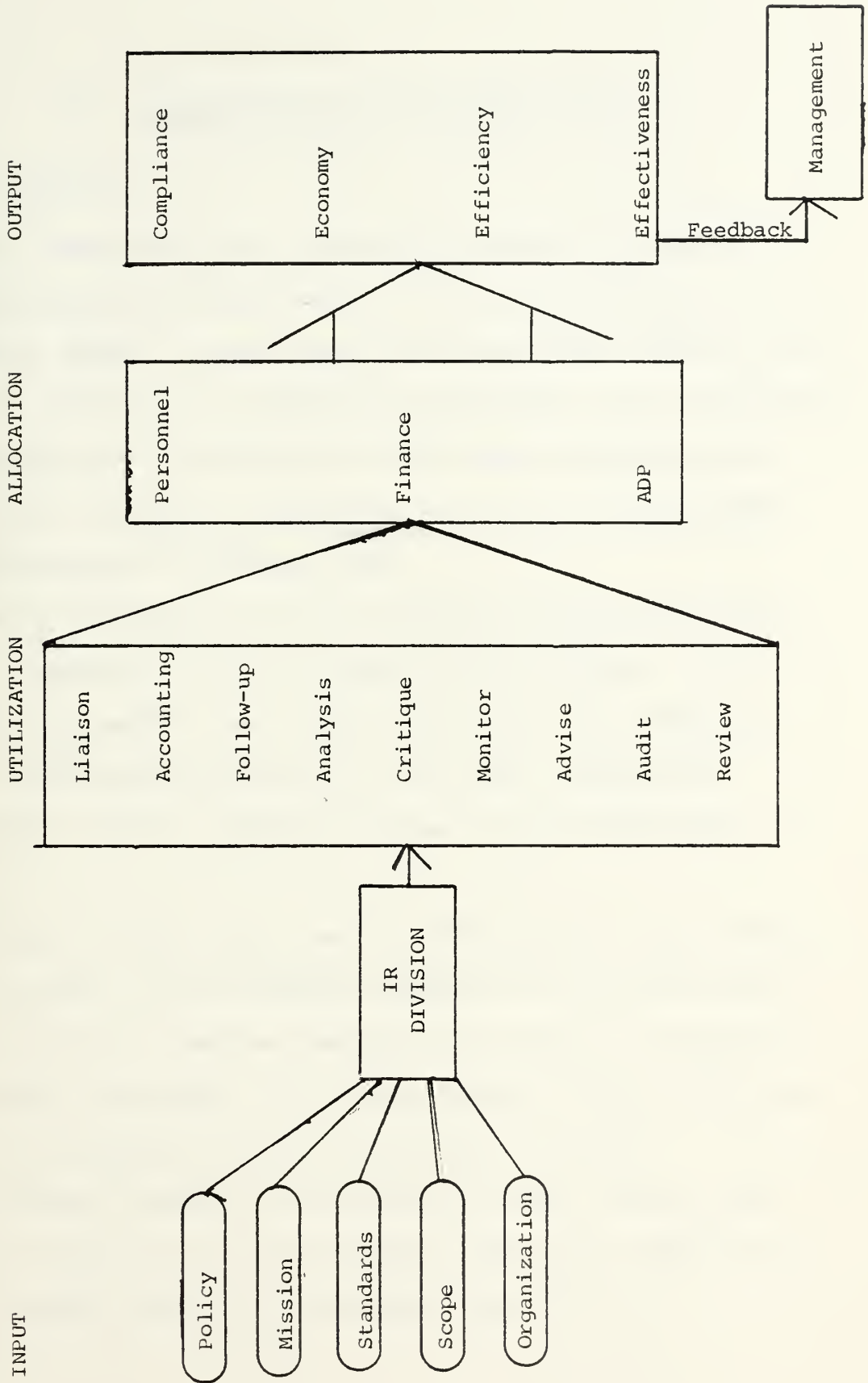


## I. SUMMARY

This chapter is the culmination of the author's research and depicts the model IR Division for NMPC. The model describes policy, mission and scope of the IR Division as well as presents the organization and desirable characteristics of the organization and its personnel. Exhibit V-6 summarizes the model and depicts the activities of the IR Division. The next chapter presents the author's comments and recommendations derived from the research into IR organizations and NMPC.



EXHIBIT V-6  
THE NMPC IR MODEL





## VI. CONCLUSIONS AND RECOMMENDATIONS

### A. INTRODUCTION

Recent budget cuts and increased emphasis on retention have highlighted the importance of the Naval Military Personnel Command (NMPC). Consequently more eyes are taking a look at NMPC to ensure it is operating efficiently and effectively. This emphasis was spurred by the new Reagan Administration and a growing concern in Congress for review and oversight in the Department of Defense (DOD).

Internal Review (IR) is an oversight function that can provide a command with an in-house review program. As previously discussed, most Naval activities and commands have not implemented Secretary of the Navy Instruction (SECNAVINST) 7510.8, "Internal Review in the Department of the Navy."

The goal of this study was to select one of these Department of the Navy (DON) Commands without an IR function and design a model for how the command's IR function should be utilized and structured. The model entails input resources, outputs, utilization and allocation of the inputs.

The command chosen by the author was NMPC because the author was familiar with the command, the large budget controlled by NMPC and their documented lack of IR.



The model was developed by a literature search into generally accepted practices and a survey of practices in use at ten entities with missions similar to that of NMPC.

In formulating the model the author observed problem areas that would arise if an IR Division were initiated at NMPC and developed some conclusions about the model and recommendations for future research. Each of these areas will be addressed in the following sections.

## B. PROBLEM AREAS

There is a tremendous amount of resistance to IR at NMPC. This resistance is led by the Comptroller who feels it is unnecessary because of all the controls that currently exist in terms of the Naval Audit Service (NAS), General Accounting Office (GAO) and other external agencies which review the operations of NMPC. Each of these auditors restricts the work of NMPC personnel, as NMPC must assist these external agencies in the execution of their audit. The general feeling from discussions with NMPC personnel is that an IR Division would not help but only further impinge on the time of the Comptroller and the personnel at NMPC.

NMPC is comprised of many divisions and subdivisions each with assigned tasks and delegated functions. To institute an IR Division would spur a negative response from many of these divisions which perceive an IR Division as a threat to their autonomy. Existing divisions would lose some of



their functions to the new IR Division thus reducing their perceived importance. To overcome this resistance the institution of an IR Division should be preceded by a broad education effort to prepare everyone and build a cadre of support for the IR Division by showing how it could help in the reduction of outside audits and improve NMPC's overall performance.

The resistance to change and generally negative connotations of IR create a real problem for the institution of an IR Division at NMPC.

#### C. COMMENTS AND CONCLUSIONS

The objective of this thesis, as previously stated, was to develop a model for an IR Division at NMPC. The research has provided the author with many insights into both NMPC and IR. These observations have led the author to the following comments and conclusions.

Comment: Survey respondents and literature search presented the author with several different methods for conducting audits. The research revealed no clear cut procedure which could be classified as a standard audit procedure.

Comment: Survey respondents were vague and unsure in answering questions on auditor training. There was no consensus on what training was desired or required for an auditor. It appeared to the author that training opportunities are not widely known.



Comment: Another area of research where survey respondents were unsure of themselves was EDP audits. Although survey respondents acknowledged the wide use of EDP audits; when it came to specific technical questions respondents refused to comment. In the author's opinion, because this area is relatively new and many executives are not conversant in its techniques they refused to comment because of their lack of expertise.

Comment: IR is widely used in the government and civilian sectors. Eight randomly selected entities responded that they utilized IR in some fashion. How IR was practiced and which characteristics and traits were portrayed depended on the mission of the activity involved. This was depicted by the lack of conformity in the answers of survey respondents with only slightly different mission.

Conclusion: The author feels that an IR function must be tailored to the mission of the activity which it serves. Further the scope of its application must be defined by the chief executives' desires. This was seen in the different applications of IR by survey respondents. Hewlett Packard utilized IR for training and compliance while the Marine Corps depended on IR for a much broader analysis and support function.

Conclusion: Because there is a variance in application and use of IR each activity or group of activities with similar missions, should develop an IR Division Model to suit their needs.



Conclusion: Very little of the research and background material for this thesis was obtained from NMPC. Initially the author attempted to work through various divisions at NMPC to develop a Model which would be considered useable by key NMPC personnel. The resistance by various NMPC Divisions to IR was overwhelming. The author was given no assistance when he identified the subject of his research. This stonewalling presented considerable problems in finding information on even simple questions such as budget figures. The author believes that their resistance to IR will create considerable problems in the actual institution of an IR Division at NMPC.

Conclusion: The model the author developed is based on the needs of NMPC. However, with some modifications it could be utilized by any major personnel activity. The basic requirements of an IR model are universal. Fine tuning is required to satisfy the particular needs of individual organizations. Survey respondents and audit literature all ascribe to the same basic audit tenants but vary in the application of those basics.

#### D. RECOMMENDATIONS

The author's recommendations are limited to the area of potential research topics. In the course of the author's study certain areas presented fertile subjects for deeper study.



1. The model the author developed for NMPC has limited application within the Navy. NMPC is the only personnel activity within the Navy and thus the only entity which could use this particular model. A model with wider application could be developed for Navy commands which have more than one branch conducting the same function. For example, Hospitals, Naval Air Rework Facilities (NARF), or Service Schools all have several commands doing the same mission in different locations. An IR model developed for a Navy hospital could be used by all Navy hospitals world-wide.

2. An extension of the first topic would be to take two hospitals or NARFS, one with an IR capability and one without and compare some measures of effectiveness and efficiency for the two commands. The variance in performance could be analyzed to determine if there was any linkage between IR and performance.

3. Take a more technical look at EDP audit techniques within the Armed Services as compared with the corporate community.

4. Follow-up on the author's model by presenting it to the Division Directors at NMPC. Survey the Division Directors' responses to the model with an eye toward evaluating the model's validity. The Division Directors could provide valuable insights into potential problems the model would encounter at NMPC.



The IR capabilities within DON Commands will not improve until more emphasis is exerted by the Comptroller of the Navy and the various purse string holders. If a command looses money because it has a weak or non-functioning IR capability it will quickly get the attention of the Commanding Officer.

Internal Review is a function whose time has come but still faces the task of convincing lower echelon commanders.



## APPENDIX A

### NAVY AUDITOR GENERAL STANDARDS

#### AUDIT STANDARDS\*

Audit standards are intended for application to audits of all government organizations, programs, activities, and functions - whether they are performed by auditors employed by Federal, state, or local governments; independent public accountants; or others qualified to perform parts of the audit work contemplated under these standards. These standards are also intended to apply to both internal audits and audits of contractors, grantees, and other external organizations performed by or for a governmental entity. These audit standards relate to the scope and quality of audit effort and to the characteristics of a professional and meaningful audit report.

A fundamental tenet of a democratic society holds that governments and agencies entrusted with public resources and the authority for applying them have a responsibility to render a full accounting of their activities. This accountability is inherent in the governmental process and is not always specifically identified by legislative provisions.

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\* This section on "Audit Standards" is taken from Standards for Audit of Governmental Organization Programs, Activities and Functions, G.P.O., Washington, D.C., 2000-00110.



This governmental accountability should identify not only the objects for which the public resources have been devoted but also the manner and effect of their application.

This concept of accountability is woven into the basic premises supporting audit standards. These standards provide for a scope of audit that includes the following elements of an audit: auditing to uncover FINANCIAL discrepancies; auditing to ensure COMPLIANCE with regulations; auditing for ECONOMIC and EFFICIENT use of resources; and assurance that desired PROGRAM RESULTS have been achieved. Provision for such an extensive scope of audit is not intended to imply that all audits are presently being conducted this way or that such an extensive scope is always desirable. However, an audit that would include provision for the interests of all potential users of government audits would ordinarily include provisions for auditing all of the above elements of the accountability of the responsible officials.

Definitions of these elements of an audit are as follows:

FINANCIAL - determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly.

COMPLIANCE - determines whether the entity has complied with applicable laws and regulations.

ECONOMY AND EFFICIENCY - determines whether the entity is managing or utilizing its resources (personnel, property,



space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures, or organizational structure.

(Note: These two elements are defined together because they are so interrelated, i.e. uneconomic practices are inefficient and inefficient practices are uneconomical.)

PROGRAM RESULTS - determines (a) whether the desired results or benefits are being achieved, (b) whether the objectives established by the legislature or other authorizing body are being met, and (c) whether the agency has considered alternatives which might yield desired results at a lower cost.

The audit standards are intended to be MORE THAN the mere codification of current practices, tailored to existing audit capabilities. Purposely forward-looking, these standards include some concepts and areas of audit coverage which are still evolving in practice but which are vital to the accountability objectives sought in the audit of governments and of intergovernmental programs. Therefore the audit standards have been structured so that each of the elements of audit can be performed SEPARATELY if this is deemed desirable.

#### GENERAL STANDARDS FOR AUDITING

The full scope of an audit of a governmental program, function, activity, or organization should encompass all elements listed previously.



In determining the exact scope for a particular audit, responsible officials should give consideration to the needs of the potential users of the results of that audit.

- The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.
- In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.
- Due professional care is to be used in conducting the audit and in preparing related reports.

#### EXAMINATION AND EVALUATION STANDARDS FOR AUDITING

In conducting an audit, the following examination and evaluation standards should be used:

- Work is to be adequately planned.
- Assistants are to be properly supervised.
- A review is to be made of compliance with legal and regulatory requirements.
- An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance with laws and regulations, and to provide for efficient and effective operations.



The characteristics of a satisfactory system of internal control would include:

- A plan of organization that provides SEGREGATION OF DUTIES appropriate for proper safeguarding of the entity's resources.
- A system of authorization and record procedures adequate to provide effective ACCOUNTING CONTROL over assets, liabilities, revenues, and expenses.
- An established system of practices to be followed in performance of duties and functions of each of the organizational departments.
- Personnel of a quality commensurate with their responsibilities.
- An effective system of internal review.

The above characteristics, as important as each is in its own right, are mutually reinforcing and all are so basic to adequate internal control that serious deficiencies in any one normally would preclude effective operation of the system. A complete review of internal controls as a specific requirement would often be prohibitive in terms of available resources. Examining all such controls would not be efficient auditing because of the irrelevance of some controls to the basic issues which are the subject of the audit effort. Therefore the auditor should concentrate his attention on those controls which are important to the issues being audited.



## REPORTING STANDARDS FOR AUDITING

Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Unless restricted by law or regulation, copies should also be made available for public inspection.

Reports are to be issued on or before the dates specified by law, regulation, or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.

Each audit report should:

- Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
- Present factual matter accurately, completely, and fairly.
- Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.
- Include only factual information, findings, and conclusions that are adequately supported by enough evidence in the auditors working papers to demonstrate or prove, when called upon, the bases for the matter



reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent to make a convincing presentation.

- Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
- Place primary emphasis on improvement rather than criticism of the past; critical comments should be presented in balanced perspective, recognizing any unusual difficulties or circumstances faced by the operating officials concerned.
- Identify and explain issues and questions needing further study and consideration by the auditors or others.
- Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
- Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions



should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.

- Clearly explain the scope and objectives of the audit.
- State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.

Each audit report containing financial information shall:

- Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with other specified accounting principles applicable to the organization, program, function or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
- Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal



or other regulatory requirements, including instances of noncompliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.



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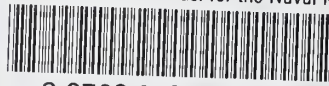
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